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GAF CORPORATION

1985

ANNUAL REPORT

You can be assured that neither GAF's Board nor its management is mesmerized by the thought of building imposing empires or increasing the size of GAF for the sake of sheer size. Quite to the contrary, we intend in our investment outlook to bring to bear the same bottom-line orientation which the Company applies on a day-to-day basis to the operation of its business."

—Chairman's letter to shareholders, August 19, 1985.

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FINANCIAL HIGHLIGHTS

| <i>(Thousands of Dollars, Except Per Share Amounts)</i> | 1985 | 1984 | 1983 |
|---|------------------|-------------------|--------------------|
| Net Sales | \$731,962 | \$ 731,314 | \$699,397 |
| Income (Loss) Before Extraordinary Credits | \$ 54,296 | \$ 41,046 | \$ (29,199) |
| Net Income (Loss) | \$ 77,581 | \$ 56,702 | \$ (3,841) |
| Earnings Per Common Share | | | |
| Primary: | | | |
| Before Extraordinary Credits | \$ 3.14 | \$ 2.62 | \$ (2.23) |
| Net Income (Loss) | 4.50 | 3.70 | (.47) |
| Fully Diluted: | | | |
| Before Extraordinary Credits | \$ 3.01 | \$ 2.30 | \$ (2.23) |
| Net Income (Loss) | 4.30 | 3.17 | (.47) |
| Cash Dividends Per Common Share | \$.20 | \$.10 | \$.05 |



GAF Corporation operates one of America's largest specialty chemicals businesses and is a leading manufacturer of building materials. The Company has 4,300 employees in 34 plants, research laboratories, and sales offices throughout the United States, and 24 marketing and service facilities abroad which serve customers in 72 countries around the world.



A state-of-the-art nuclear magnetic resonance spectrometer determines detailed molecular structure of surfactants and acetylenic derivatives. Shown here are three-dimensional spectra of N-vinylpyrrolidone, a key GAF product.

The Company's Chemicals Division manufactures four major groups of products—acetylene derivatives, surfactants, engineering thermoplastics, and mineral granules, holding a significant market share in each of these principal product groups. GAF chemicals have a broad range of applications, encompassing such major markets as automotive, agricultural, pharmaceuticals, hair and skin care products, plastics, oil and gas, textiles, paper, and rubber. Foreign chemicals markets represent an increasingly important source of GAF's revenues and profits. Overseas, the Company also distributes a complete line of pressure-vessel filter systems to most major industries, and through a joint venture manufactures butanediol and tetrahydrofuran in West Germany.

The Building Materials Division is one of the country's major manufacturers of roofing products, including prepared roofing for residential construction and remodeling markets and roofing products for commercial and industrial buildings. Its residential roofing sales are oriented 70 percent to the re-roofing market and 30 percent to new home construction.

GAF owns and operates a New York City-based radio station, WNCN-FM, which provides classical music and cultural programming.

GAF Corporation is ranked among *Fortune* magazine's 500 largest American industrial corporations.

GAF ON THE MOVE IN 1985

As demonstrated by the following chronology, GAF was on the move in 1985, compiling an impressive list of accomplishments, which included its best earnings performance in its 20 years as a public company.

January 2

GAF introduces its newest asphalt roofing product, Royal Sovereign[®], a high performance, residential roofing shingle designed to capitalize on the emerging "middle market" for quality roofing shingles.

January 22

GAF calls for redemption 1,138,000 shares of its \$1.20 Convertible Preferred Stock.

February 1

GAF introduces Gaffix VC-713[®], a new generation of hair care fixatives.

February 11

GAF announces plan to manufacture Ruberoid MB[®], a promising new single-ply roofing system, at Mount Vernon, Indiana plant, underscoring the Company's commitment to its commercial roofing business. Expansion is to be financed by a \$4.8 million industrial revenue bond issue.

February 19

GAF completes expansion of its production capacity for manufacture of Polypladone[®] and Polycel[®] at its Calvert City, Kentucky plant.

March 18

GAF calls for redemption the remaining outstanding shares of its \$1.20 Convertible Preferred Stock.

April 17

GAF reports its fifth consecutive quarter of sharply increased earnings, posting the highest first quarter earnings in the Company's history.

Income before extraordinary credits was \$11.1 million (\$.62 per share on a fully diluted basis), compared with \$7.4 million (\$.42 per share) a year earlier. Chemicals Division reports the best quarter in its history, while Building Materials Division reports its best first quarter in five years.

April 18

Groundbreaking is held in connection with expansion of butanediol capacity at GAF's joint venture plant in Marl, West Germany.

April 29

Carl R. Eckardt and John A. Brennan elected Presidents, GAF Chemicals Division and Building Materials Division, respectively. Both remain Senior Vice Presidents of the Corporation.

April 29

Based on 1984 performance, *Fortune* magazine ranks GAF 11th in total return to investors, 23rd in net income as a percent of stockholders' equity, and 92nd in net income as a percent of sales among the nation's 500 largest industrial companies.

May 10

GAF acquires Reichhold Chemicals' Glass Fiber Division for \$9.25 million. Financing for the acquisition and related capital expansion programs is obtained through the issuance of industrial revenue bonds in the aggregate amount of \$13.5 million.

June 3

GAF issues \$150 million of ten year, 11 3/8% senior subordinated notes, the largest financing in GAF's history.

July 17

GAF reports the highest second quarter earnings in its history, the sixth consecutive quarter of sharply increased profits. Income before

extraordinary credits was \$15.4 million (\$.86 per share), compared with \$11.9 million (\$.67 per share) a year earlier. Chemicals Division posts record income for the quarter, while Building Materials reports its best second quarter in seven years.

August 14

GAF announces it has acquired 3,943,600 shares of Union Carbide Corporation, or 5.6% of that company's total outstanding shares. In a filing with the SEC, the Company states that a business combination between GAF and Carbide is among the possibilities being considered.

October 17

GAF reports its seventh consecutive quarter of sharply increased earnings, with the Chemicals Division recording its most profitable third quarter ever and the Building Materials Division posting its best quarter in five years. Income before extraordinary credits was \$15.6 million (\$.87 per share), compared with \$12.1 million (\$.68 a share) a year earlier.

December 9

GAF announces tender offer for 80% of Union Carbide's outstanding shares.

December 13

GAF completes expansion of its production capacity for manufacture of butanediol at Calvert City, Kentucky plant.

December 26

GAF amends Union Carbide offer, proposing to pay \$74 per share, all cash, for 100% of Union Carbide shares.

December 31

GAF common stock closes at \$59, having increased by 140 percent from \$24 1/2 a year earlier.

OFF TO A STRONG START IN 1986

January 1

GAF begins a year-long commemoration of the 100th Anniversary of the formation of the company that later became Ruberoid, the predecessor of GAF's Building Materials business.

January 2

GAF proposes to increase its offer for 100% of Union Carbide's outstanding shares to \$78 per share.

January 8

GAF announces withdrawal of its tender offer, stating that it is not in the best interests of GAF shareholders to compete against Union Carbide's own exchange offer. GAF tenders 3.5 million Carbide shares into that company's exchange offer, while retaining more than 3.2 million Union Carbide shares, constituting more than 10 percent of that company's outstanding shares. With respect to GAF's Carbide shares accepted in the exchange offer, GAF discloses that it expects to record a pre-tax gain of approximately \$90 million and an after-tax gain of approximately \$81 million, or \$4.50 per share of GAF common stock, in the quarter ending March 31, 1986.

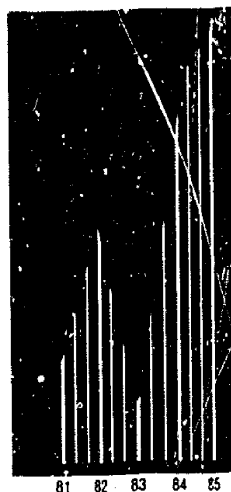
February 6

GAF completes expansion of commercial roofing manufacturing facility at Fontana, California.

February 11

GAF reports record earnings for 1985, with income before extraordinary credits reaching \$54.3 million (\$3.01 per share), compared with previous year's \$41.0 million (\$2.30 per share). Chemicals Division and GAF Broadcasting register record profits, while Building Materials Division posts its best year since 1979.

EARNINGS PER SHARE
(Dollars)



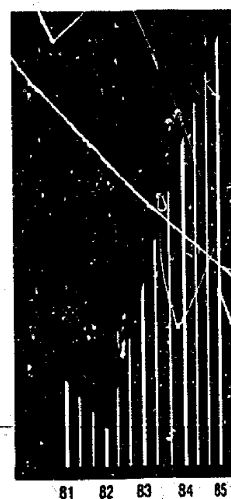
COMMON STOCK PRICE
(Dollars)



NET INCOME
(\$ in Millions)



OPERATING INCOME
AS % OF SALES



"Net Income" represents income (loss) before extraordinary credits. "Earnings Per Share" represents earnings before extraordinary credits on a fully diluted basis. "Common Stock Price" is GAF's common stock price as of December 31 of each year.

CHAIRMAN'S MESSAGE

Fellow Shareholders:

It is with considerable pride that I report to you on another year of achievement for GAF—a year in which the Company's impressive list of accomplishments included GAF's best earnings performance in its 20 years as a public company.

1985 Financial Results

For the twelve-month period ended December 31, 1985, income before extraordinary credits was \$54.3 million (\$3.01 a share on a fully diluted basis), compared with income of \$41.0 million (\$2.30 a share on a fully diluted basis) for the previous year. Division operating profits increased from \$90.6 million in 1984 to \$113.8 million in 1985, while revenues were \$732 million compared to \$731.3 million in 1984.

For the fourth quarter of 1985, income before extraordinary credits was \$12.2 million (\$.67 a share) versus \$9.6 million (\$.54 a share) for the 1984 period. Sales for the fourth quarter were \$174.2 million, compared with \$166.3 million for the same period a year earlier.

The Company's operating results included record-breaking Chemicals profits of \$92.6 million and a substantial improvement in the performance of its Building Materials Division from a profit of \$10.9 million in 1984 to \$20.1 million in 1985. The Company's 1985 performance was favorably influenced by increased unit sales for most all its product lines, a more favorable product mix in both its businesses, increased manufacturing efficiencies, and rigorous cost control programs. Contributing to the improved performance was a 17% cutback in corporate operating expenses from \$18.5 million in 1984 to \$15.4 million in 1985.

Significant 1985 Developments

GAF's financial performance in 1985 was paralleled by an equally imposing record of achievement in practically its every undertaking. Whether it was in terms of new prod-



Samuel J. Heyman
Chairman of the Board
and Chief Executive Officer

James T. Sherwin
Vice Chairman and Chief
Administrative Officer

uct development, the most ambitious capital expansion program in the Company's history, recruitment of outstanding executives to the Company, implementation of unique incentive compensation programs at virtually every level of the Corporation, a successful \$150 million bond offering, increased manufacturing efficiencies, intensification of the Company's cost control programs, etc., GAF was unmistakably on the move in 1985. While other parts of this Annual Report chronicle the Company's accomplishments in many of these areas, I would prefer to provide you, in this Message, an overview of several of the most significant developments at GAF during this past year.

Chemicals Business in 1985: Continued Earnings Gains While Building for the Future

The Chemicals Division registered in 1985 its third consecutive year of sharply increased operating profits, having advanced from \$55.4 million in 1982 to \$64.6 million in 1983 to \$79 million in 1984 and \$92.6 million in 1985. The 17% increase in GAF's Chemicals profits for 1985 was achieved as a result of higher unit sales for most all the Division's principal products, a more favorable product mix, and continued cost reductions at both administrative and plant levels.

This remarkable performance was all the more so given the fact that several of the end user markets for GAF products experienced depressed business conditions this past year and, further, that the chemicals industry itself registered in 1985 an earnings decline of 18% from 1984 levels. In this latter connection, the 42.6% return on assets achieved by GAF's Chemicals business in 1985 is further illustration of why the Division's outstanding financial performance continues to set the standard for the chemicals industry.

During this past year, GAF pursued a strategic direction whose major elements included continued capital expansion and significant initiatives in the product development area, both of which should enable the Chemicals Division to continue its rate of earnings growth in 1986.

Capital Expansion

GAF continued its ambitious capital program in 1985 and completed during the year several projects involving a substantial increase in production capacity at its Calvert City, Kentucky plant. An additional expansion, at our joint-venture manufacturing facility at Marl, West Germany will be completed in mid-1986.

The Chemicals Division's capital expansion program, initiated in late-1984, scheduled for completion in

1986, and involving an aggregate investment of \$95 million, will provide GAF with sufficient capacity to serve its customers for the balance of the decade and beyond. Moreover, the fact that GAF's strategic plan has included capacity increases at both domestic and international facilities, with each of these locations utilizing a different source of acetylene (a key raw material in our manufacturing process), has enabled GAF to achieve a measure of diversification sufficient to assure its role for many years to come as a reliable, low cost supplier of quality products to its customers.

New Product Development

GAF accelerated both its activity and investment in research and development in 1985. In this connection, the Chemicals Division increased its annual expenditures in this area by 20% over the previous year, and a further increase is projected for 1986.

GAF's philosophy concerning the expansion of its research and development operation is that such activity is best nurtured not by the indiscriminate investment of financial and human resources but rather by a careful, deliberate endeavor to assemble at GAF a select group of outstanding scientists who bring, in their approach to research, a concern not only for the science itself but an appreciation for the relevant business and market considerations as well. Although an important aspect of the Division's research and development activity involves support programs designed to maintain and improve the quality of GAF's products while at the same time reducing their cost of production, a continually increasing portion of the Company's endeavor in this area is now being devoted to development of new products and new applications for GAF's existing products. Significantly, GAF's new product development activity is now fully coordinated with the Division's marketing department to assure that critical interplay between research

and development and marketing disciplines.

While the increased investment entailed in the acceleration of the Chemicals Division's research and development activity cannot be reasonably expected to yield immediate results, it is noteworthy that GAF did introduce into the market this past year a number of significant new products. These product introductions included a new generation of hair fixatives based on GAF-developed technology for mousses and styling gels; unique thermoplastic polymer blends suitable for electronic applications, the expanding automotive body panel market, and undersea oil and gas drilling components; a new family of low-foaming, high detergent surfactants for household and industrial uses; and new and improved grades of Gaflex® thermoplastic polyester elastomers for applications where resistance to fatigue and temperature extremes is required. It is anticipated that these new products will make an increasing contribution to operating profits in 1986 and beyond.

Building Materials Business in 1985: Increased Profitability Through Greater Market Share, More Favorable Product Mix, and Low Cost Production

Operating profits in the Building Materials Division nearly doubled in 1985, despite another lackluster year for the roofing materials industry. Improved performance of GAF's roofing materials business resulted from higher unit sales, a more favorable product mix, and increased manufacturing efficiencies—the latter having enabled GAF to become one of the lowest cost producers in the industry. The Division's performance was all the more impressive when measured against an industry environment which witnessed reductions in prices for roofing materials products and total sales. Finally, an especially noteworthy accomplishment was the fact that GAF, by virtue of a

substantial increase in its market share this past year, has now attained pre-dominance as the nation's leading manufacturer of residential roofing products.

GAF acquired in May, 1985, Reichhold Chemicals' Glass Fiber Division for \$9.25 million, in a move designed to ensure increased control over the Division's manufacturing costs as well as its enhanced reliability as a supplier. This business, which includes manufacturing and research and development facilities at Nashville, Tennessee and Irwindale, California has now been devoted to the manufacture of chopped glass fiber for mat substrate used in the Company's roofing products. With its own captive supply of glass fiber, glass mat, and roofing granules, GAF has become the most fully integrated roofing manufacturer in the industry. This provides the Company's building materials business, we believe, with a distinct advantage over its competition and has already enabled GAF to further reduce its manufacturing costs—a critical objective in an industry where severe competitive pressures have exerted downward pressure on prices for quite some time.

The major elements of the Division's marketing strategy this past year were to achieve a more favorable product mix and distinguish itself and its products in the marketplace. To this end, GAF successfully pursued a number of initiatives, two of which are worthy of mention at this time.

(1) GAF's Building Materials Division developed and introduced into the market two exciting new products this past year, both of which are expected to make a significant contribution to the Division's profits in 1986. The Royal Sovereign®, a durable residential shingle, is designed to capitalize on the "middle market" for quality roofing materials at a just slightly higher price than standard shingles. This new high-performance, designer-created product is experiencing rapidly increasing sales

and can be expected to be a meaningful contributor to profits in 1986. GAF also developed and brought to market in the latter part of 1985, Ruberoid MB[®], a modified bitumen single-ply roofing system. This exciting new addition to GAF's line of commercial roofing products offers the advantages of improved flexibility, ease of application, and cost efficiency, and its development underscores GAF's commitment to establish itself as the premier supplier of commercial roofing products.

(2) GAF continued during the past year to increase market penetration of its premium roofing product, Timberline[®]. Programs designed to promote increased sales of this product included expansion of the GAF Finance Program, an innovative plan enabling roofing customers purchasing Timberline and other GAF roofing products to obtain prompt and easy home improvement loans on competitive terms, and the launching of a nationwide, radio advertising campaign featuring the theme from "Fiddler on the Roof." As a result of these initiatives, Timberline enjoyed substantially higher sales throughout the country this past year, and further gains are expected in 1986.

GAF's Union Carbide Investment

GAF began accumulating shares of the Union Carbide Corporation in June, 1985. By August, GAF had acquired almost 7 million shares, constituting a 9.9% interest in Carbide, at an average cost of \$51 per share. While the shares were initially acquired because they presented an attractive investment opportunity, further analysis compelled GAF to conclude that: (1) Union Carbide, which consists of several attractive chemicals units, was in many respects an excellent strategic fit and acquisition opportunity for GAF; and (2) Despite the size of Union Carbide, our Company's standing in the investment community and its

proven management talent would enable it to not only raise sufficient financing for the acquisition but, in the event that an acquisition effort were successful, to successfully incorporate this more sizeable enterprise into GAF's own operations.

On December 9, 1985, GAF launched a tender offer for 80% of the common stock of Union Carbide at \$68 per share. After GAF subsequently increased its offer to \$78 per share, all cash, for 100% of the outstanding Carbide shares, Union Carbide proposed a plan similar in some respects to GAF's own agenda for the company. Union Carbide's program called not only for divestiture of a number of business units (including its Consumer Products segment) but for a broad-based cost cutting effort. When coupled with a competing exchange offer for a substantial portion of its own outstanding shares, Carbide's plan of action would have required GAF to substantially increase its offer in order to have had a realistic chance of success. Under the circumstances, GAF determined that it was not in the interests of its shareholders to continue to compete against Carbide's own exchange offer.

GAF instead tendered its own Carbide shares into the company's exchange offer, exchanging almost one-half of its position for a package of cash and securities having an approximate value of \$85 per share. With respect to the shares taken in the exchange offer, GAF expects to record, in the quarter ending March 31, 1986, a pre-tax gain of approximately \$90 million and an after-tax gain of approximately \$81 million, or \$4.50 per share of GAF common stock. GAF will continue to retain approximately 3.2 million shares of Union Carbide, consisting of 10.6% of Carbide's outstanding shares, and will determine at a later time whether it wishes to renew its tender offer or pursue other alternative courses of action.

The determination to withdraw GAF's offer for Union Carbide was in keeping with the Company's acquisition philosophy, as outlined in my August 19, 1985, letter to you:

"You can be assured that neither GAF's Board nor its management is mesmerized by the thought of building imposing empires or increasing the size of GAF for the sake of sheer size. Quite to the contrary, we intend in our investment outlook to bring to bear the same bottom-line orientation which the Company applies on a day-to-day basis to the operation of its business. In so doing, our criterion for expansion at GAF will continue to be measured in terms of maximum return on capital, contribution to earnings, and enhancement of shareholder values."

Although GAF fell short of its goal to acquire Union Carbide, its investment has been a financially successful one. Based upon the current market price of Union Carbide's shares, GAF has pre-tax realized and unrealized gains, after expenses, of approximately \$175 million. Moreover, GAF can derive satisfaction from the fact that it has not only done well for its own shareholders but has succeeded in creating for Carbide shareholders more than \$3 billion of increased shareholder value. Finally, GAF expects to maintain its ownership interest in Union Carbide. As that company's major shareholder, we intend to closely monitor further developments and have retained the flexibility to pursue at a later time whatever course of action we determine to be in GAF's best interest.

Prospects for 1986

As we move into 1986, GAF's two principal businesses continue to outperform the industries in which they operate. Although GAF serves several markets which currently suffer from less than robust economic conditions, I nevertheless have every

confidence that we can continue to improve the profitability of the Corporation and register substantial year-to-year earnings increases in 1986.

As for the Company's Chemicals Division, we anticipate another outstanding year. In this regard, results should be favorably influenced this year by expansions of our production capacity, new product development, a lower dollar, the anticipated rebound of a number of end user markets, such as electronics, plastics, and magnetic wire coating, and increased marketing penetration in areas of the world whose potential we have not yet begun to tap. In this latter connection, results thus far provide sufficient basis to expect that international profits will make an even more significant contribution to the Division's overall performance in 1986.

With regard to the Company's Building Materials Division, while operating profits were sharply higher than those of the previous year, the business is still far from achieving acceptable returns on capital. Although GAF in 1985 managed to improve market share and sharply reduce its cost of doing business at both administrative and plant levels, its efforts to achieve greater profitability were inhibited by continued erosion of pricing in the roofing materials industry. In this connection, current prices for GAF's roofing products have now fallen to a point below 1979 levels as a result of industry-wide overcapacity, a condition which has persisted for quite some time. Although 1985 witnessed a number of plant closings which operated to remove capacity from the industry, and while it would appear that roofing prices have at least stabilized over the period of the past ninety days, it is still too early to tell whether pricing will return to at least some semblance of normalcy in the current year. In any event, we remain confident that GAF's building materials business can continue to effectively compete in a challenging

environment, and that 1986 results will demonstrate further improvements over the prior year.

Acknowledgments

GAF's record of accomplishment over the past year was attributable to the exemplary efforts of so many members of the GAF community, and I am delighted to take public cognizance of their many contributions to the success of our common endeavor.

I would first acknowledge the pivotal role played by GAF's Board of Directors. Through a willingness to analyze, examine, question, deliberate, disagree, and finally arrive at a consensus, sometimes after reconciliation of differences, each of our directors has made an inestimable contribution to the affairs of the Corporation. This is so not only because of the wisdom of their advice and counsel in the formulation and establishment of policies from which GAF's executive direction has stemmed, but also because of the constancy of Board support for both the endeavors and fundamental principles of our Corporation.

Foremost among the causal factors in what we have achieved at GAF over the past two years has been, and continues to be, my fellow GAF employees. As Chief Executive, I consider myself fortunate to be associated with so many hard working, dedicated, and loyal employees who approach their responsibilities and share the objectives of GAF's senior management with such an extraordinary degree of intensity.

On a related note, it is worthy of mention that more than 25% of our entire employee population—salaried, hourly, union and non-union—are shareholders of the Corporation. The degree of employee participation in the ownership of GAF is highly unusual, if not unique, in corporate experience and has contributed in no small measure to the creation at GAF

of a corporate ethic in which employees treat the Corporation's money as if it were their own—as, in fact, it is!

And, finally, I would express my gratitude to our shareholders for their continued support and encouragement. It has been and is no secret that I care for and about my fellow GAF shareholders, and that our philosophy of management at GAF emanates from a clear view of for whom and by whom corporate management is employed. While it is ever the role of the Chief Executive and the Board of Directors to reconcile the many competing interests of those in the GAF community at large, it is our simple credo that only through sustained achievement for the Company's shareholders can we assure the well-being of our employees, customers, suppliers, lenders, and communities in which GAF does business. And it is therefore with no small measure of pride that I recount the fact that over the period of the two years of new management's term of office we have managed, by virtue of our efforts, to increase shareholder wealth by more than \$900 million.

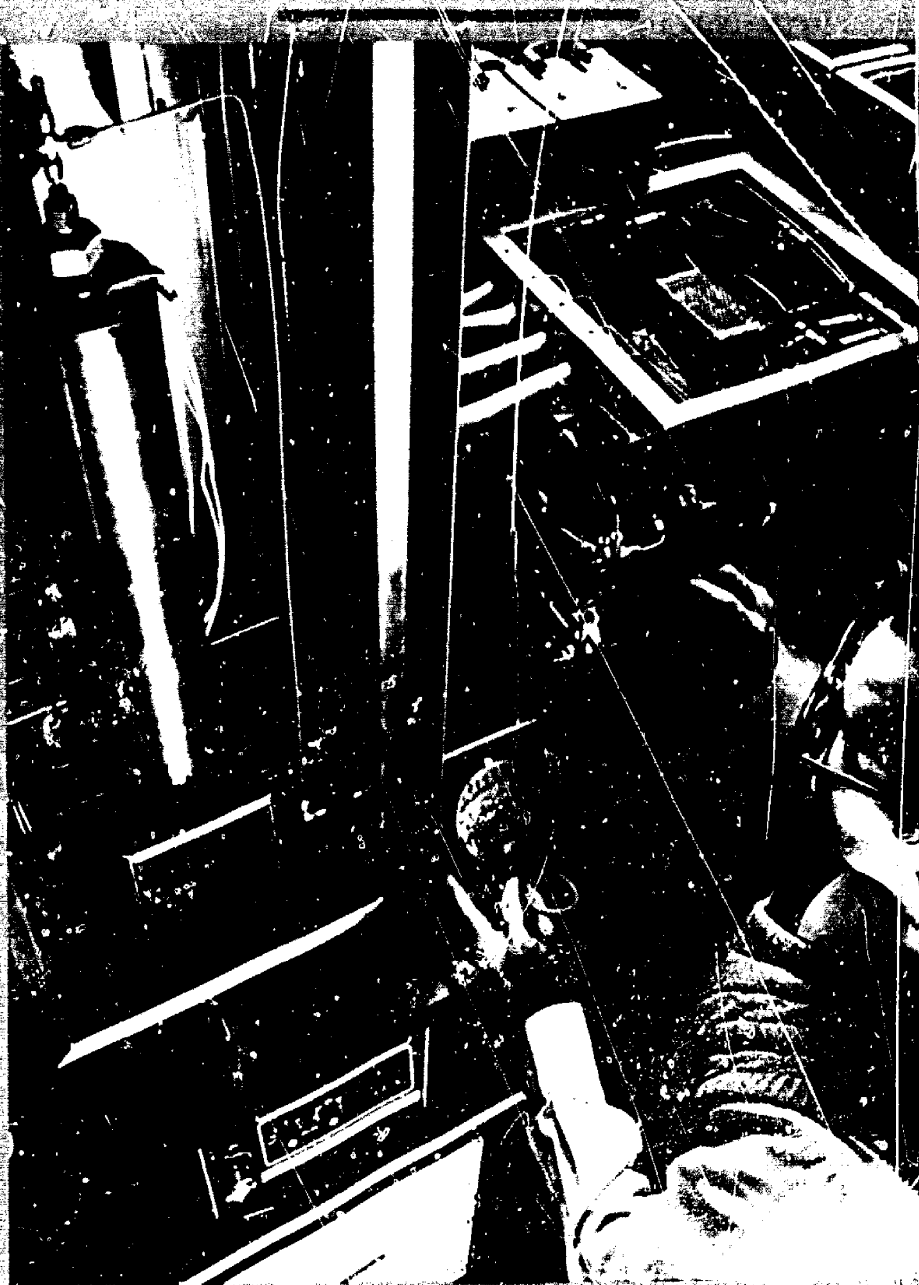
We trust that we can continue to report such favorable developments in the coming year.

Sincerely,



Samuel J. Heyman
Chairman of the Board
and Chief Executive Officer

March 17, 1986



*This custom-designed
computerized micro-pilot plant reactor is utilized for analyzing
complex chemical reactions. Data from these studies
are important in optimizing new plant processes.*

GAF's worldwide specialty chemicals business achieved record profits in 1985. Division income reached \$92.6 million, a 17% gain over the previous year. Sales increased to \$364.4 million from \$357.2 million in 1984. Results in both years include income from GAF's 50-percent-owned foreign chemicals manufacturing and sales company, GAF-Hüls Chemie GmbH.

Domestic operating income rose to \$64.8 million in 1985, a 17% gain over the year-earlier level of \$55.3 million. Domestic sales increased from \$260.9 million to \$264.7 million, reflecting increased market penetration for virtually all major product lines which was partially offset by reduced selling prices. Despite the continued strength of the dollar through most of the year, international profits increased from \$23.7 million in 1984 to \$27.8 million in 1985, while international sales for the 1985 year were \$99.7 million compared to \$96.3 million in the previous year. The Division's overall profit performance resulted in part from an improved product mix as well as the successful implementation of a wide variety of programs to effect manufacturing efficiencies and energy cost reductions.

The Chemicals Division produces three major groups of specialty chemicals at five domestic facilities—acetylene derivatives and surfactants for markets in 72 countries around the world and engineering plastics for markets located principally in the United States and Canada. A fourth product line, mineral roofing granules, is manufactured at four domestic plants and sold to asphalt roofing manufacturers nationwide, including GAF's own Building Materials Division. These pebble-like granules are developed from specially selected rock and are quarried, crushed, coated, and heat-processed by GAF into semi-ceramic granules in more than 20 colors.



Carl R. Eckardt
President,
Chemicals Division

Acetylene Derivatives

GAF's line of more than 70 different acetylene derivatives experienced significant growth in 1985. The Company's strength in acetylene derivatives—as evidenced in its technology, multi-source plants, broad product line, application research, and dedication to quality—has resulted in increased demand for the Company's existing products and the successful introduction of new and improved products.

Sales of butanediol to producers of thermoplastic engineering plastics increased substantially in 1985. These plastics are finding increasing application in the automotive, electronics, and appliance industries. In addition, sales of butanediol for urethane and plasticizer end-uses continued to meet increased customer demand.

GAF's acetylene-derived solvents, M-Pyrol[®], BLO[®] and THF[®] demon-

strated continued growth by penetrating specialty solvent markets, where high performance and safety are critical requirements.

Major petroleum refining companies stepped up their demand for M-Pyrol, GAF's super-safe solvent. This growing demand was attributable to increased recognition of the product's superior performance characteristics, in terms of both cost efficiency and environmental safety, in the extraction of automotive lubrication oil. As a result, M-Pyrol has virtually replaced phenol solvent in this petroleum refining application. M-Pyrol also made further inroads this past year in markets previously dominated by furfural, another widely used extraction solvent.

Applications for acetylenic solvents continued to expand as a result of both restrictions placed on exposure to chlorinated solvents in a variety of applications and action taken by the United States Environmental Protection Agency in 1984 granting M-Pyrol exempt status for use in agriculture. M-Pyrol is especially suitable for use in the agricultural market because of the latter's requirement for improved safety characteristics in connection with products used in herbicides, pesticides, insecticides, and fungicides.



GAF chemicals and polymers are increasingly used in a great variety of pharmaceutical and healthcare products.

Laboratory distillation equipment is employed for the fundamental study of the organic reactions leading to GAF specialty chemical products.



Expanded manufacturing facilities for "Polyplasdone" and "Polyclar," key acetylene-based polymers used in pharmaceutical formulations and as clarifiers in the beverage industry.

Sales of fixative polymers to the haircare market reached substantially higher levels in 1985. GAF's Gafquat* polymers gained increased acceptance in styling products such as mousses. Hair mousses have been one of the fastest growing new products to reach the haircare market in more than a decade.

Gantrez* resins, used extensively in hair sprays, continued to maintain their market leadership. Gaffix* VC-713, a new generation polymer, was introduced during the year, thereby expanding GAF's product line in the hair fixative market.

GAF's line of Polyplasdone* disintegrants, used by major drug manufacturers around the world for pharmaceutical tablets, registered increased sales growth last year. In order to satisfy rapidly growing demand for Polyplasdone disintegrants and Polyclar*, GAF expanded its production capacity at the Company's Calvert City, Kentucky facility. Polyplasdone disintegrants are used primarily in pharmaceutical tablets, while Polyclar is employed as a stabilizer and clarifying agent in the production of beer, wine, fruit juices, and other beverages.

New product applications contributed to increased demand for Plasdone* excipients in the pharma-



ceuticals industry. One such successful development has been the use of Plasdone excipients in new transdermal devices to provide constant, controlled-release medication over long, periodic periods of time. Plasdone excipients are also employed as binders for drug and vitamin tablets in both the medical and veterinary markets.

Surfactants

GAF experienced significant growth in unit sales of surfactants, notwithstanding the fact that the overall surfactant market registered

flat sales in 1985 as compared to the previous year. GAF's positive performance was attributable to expanded applications for existing products, new product applications, and improved market penetration.

GAF's surfactants include the Igepal* series of alkylphenol ethoxylated nonionics and the Alipal* Gafac* and Igepon* series of anionic surfactants. Several new Alipal surfactants were developed during 1985 which expanded our sales to customers producing latex bases for paint and specialized coatings. Igepals continued to register strong sales to the household cleaner and agricultural chemical markets. The demand for Gafac as resin emulsifiers and Igepals as deinking chemicals remained strong, notwithstanding the effect of increased foreign competition in the paper industry in the United States.

GAF's Igepon line of surfactants continued to gain increasing use in the cosmetics market. Igepon AC-78 is a widely used product among manufacturers of low-irritation synthetic soap bars and other new toiletry products. In addition, other surfactants, such as Igepon T-77, experienced higher sales to the agricultural market.

Sales of carbonyl iron powders, although adversely affected by the downturn in the electronics industry, experienced increased demand in the defense and powdered metallurgy industries.

Engineering Thermoplastics

GAF's engineering thermoplastic business, in terms of its sales for automotive and extrusion applications, continued its growth pattern in 1985. While the electrical/electronics markets were depressed during most of the 1985 year, sales in both these sectors improved during the latter part of the year as inventories were reduced and customer demand began to rebound.

A number of significant developments occurred in 1985 which should

The GAF family of specialty chemicals and polymers are incorporated into the products of most high growth industries: pharmaceuticals, cosmetics, household, industrial and institutional, automotive, and electronic and electrical components.



Scanning electron microscopy, here used to characterize carbonyl iron powder (inset): 5000X magnification of Type SF material employed in the fabrication of electronics parts.



enable GAF to continue its rapid expansion of this business in the coming year:

- Gafite® PBT alloys have been widely accepted for use in auto ignition applications, where there is a premium on excellent electrical performance and smooth surface finish.
- A UV stabilized Gafite PBT material has been developed for applications exposed to extreme direct sunlight. In addition, expanded applications for pigmented parts requiring UV protection are presently being developed.
- A foamable PBT grade is scheduled for market introduction in 1986. This new material offers potential for weight reduction while retaining the excellent combination of properties associated with conventional PBT.
- New high impact PBT materials have been developed and are now being marketed to the electrical/electronic connector market.
- Similar technology has been utilized to provide high impact alloys of PBT for use in exterior automotive parts.
- New grades of Gaflex® thermoplastic polyester elastomers, were first introduced in 1985, while the entire Gaflex line is finding expanding applications where resistance to fatigue, corrosion, and temperature extremes is required.

Mineral Products

GAF's granules business registered increased sales during 1985, despite the lack of industry-wide growth in asphalt shingle shipments. In order to satisfy increased customer demand, production capacity was expanded at our Blue Ridge Summit, Pennsylvania and Annapolis, Missouri plants during the past year.

The Division's granules business continued to benefit from the current trend among roofing manufacturers to convert production to glass

fiber substrate, the glass product requiring more granules per unit of asphalt roofing. In addition, the increased popularity of three-dimensional shingles which simulate wood, such as GAF's premium Timberline® shingle, has resulted in increased granules demand on account of the fact that they require 30% more granules than lower-cost, commodity shingles.

International

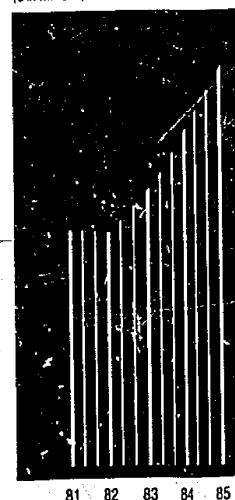
Despite the continued strength of the dollar through the greater part of the year, international profits increased from \$23.7 million to \$27.8 million for the 1985 year, while sales were \$99.7 million versus \$96.3 million in 1984. In achieving record results, GAF's international chemicals business accounted for 27% of the Company's total chemicals sales while contributing 30% of the Division's profits.

The Chemicals Division's international business is conducted by 15 subsidiary companies throughout the world and through distributors in those countries which do not have a GAF subsidiary. Key products for international markets are acetylene derivatives, surfactants, and a range

of pressure-vessel filter systems. These filter products are manufactured in Belgium, Germany, Brazil, and Canada for use in the filtration of process liquids in industries, such as chemicals, pharmaceuticals, paints, and beverages. GAF is recognized as a market leader in this product line.

The Company participates in a joint venture operation in Marl, West Germany, GAF-Hüls Chemie GmbH.

CHEMICALS INCOME
(\$ in Millions)



GAF specialty surfactants are widely used in a broad line of household products.

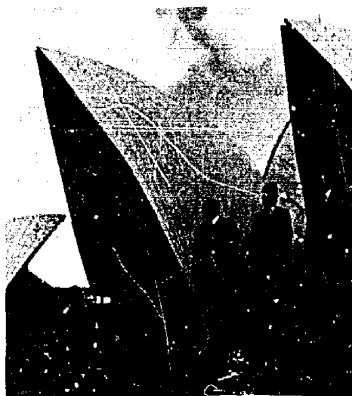


GAF's growing international presence—including the Australasia and North Pacific regions—offer new and expanding market opportunities.

GAF-Hüls manufactures butanediol and tetrahydrofuran (THF), a chemical intermediate and solvent, respectively. These products are marketed throughout Europe by both the GAF sales force and GAF-Hüls. The joint venture manufacturing facility is currently undergoing a major expansion of its present capacity. This expansion, scheduled for completion in mid-1986, will enable GAF to increase market penetration in not only Europe but in export markets throughout the world, such as the North Pacific.

International operations are divided into four geographic regional units, the largest of which is the European region. The European unit has responsibility for the Middle East, Africa, and the Indian subcontinent, as well as all European markets. Sales in the European region for 1985 increased by more than 8% over 1984 levels, notwithstanding the continued strength of the dollar during most of the year.

Plasdone and Polyplasdone in the pharmaceutical industry and Polyclar in the brewing industry continued to experience strong overseas demand. GAF maintained its position as a leading supplier to the hair care industry



through increased sales of Gafquat and other polymers used in styling mousses, a very important market segment in Western Europe and a growth area in other parts of the world as well. Sales of BLO, THF, and butanediol for agricultural formulations continued their strong growth patterns in 1985.

Western Hemisphere sales increased by more than 8% in 1985, despite the adverse impact of high inflation rates and continued currency devaluations in most Latin American countries. GAF operates through subsidiaries in Canada, Brazil, and Mexico and through distributors in other countries in that region. A strong performance was recorded throughout the Hemisphere by GAF's filter business and sales of

polymers to the pharmaceutical and hair care industries.

The Australasian region experienced lower U.S. dollar sales in 1985, both as a result of the recession in the electronics industry which severely impacted the Company's operations in Southeast Asia, and also due to a 25% decline in the exchange rate of the Australian dollar. GAF is a leading supplier in that part of the world of M-Pyrol, which is used extensively in semiconductor microchip production. Partially offsetting the decline were strong advances in polymers to the hair care industry, where Australasian markets are now adopting formulations similar to those already widely accepted in Europe and the United States.

Sales in the North Pacific region for 1985 increased by 10% over 1984, largely on account of significant unit volume increases in acetylenic derivatives. Lower sales of M-Pyrol, resulting from the depressed state of the semi-conductor industry, were more than offset by substantial increases in the other acetylenic product lines and new business in Korea and the Peoples Republic of China.

Research and Development


GAF's research and development activities received increased attention and emphasis in 1985. Research and development expenditures for 1985 increased 20% over 1984 levels and reflect management's strategic commitment to the development of expanded specialty product lines and new systems.

Thirty additional scientists, engineers, and support personnel were added to the research staff in 1985, and GAF's expanded research and development staff is now devoting an increasing portion of its time to the development of new products for the Company's strongest growth markets. Among the new products GAF introduced this past year were:

- A new generation of hair fixatives based on GAF-developed technology for mousses and styling gels. These



GAF specialty chemicals play a key role in the manufacture of pharmaceutical, cosmetic, and industrial products in Japan and the North Pacific.



GAF engineering plastics and elastomers—major materials used in the dynamic automotive, electronics, electric, and home appliance markets.



The cosmetics market—one of the larger users of GAF specialty surfactants and polymers for hair sprays and mousses, shampoos, and gels.

innovative materials exhibit superior holding properties, are compatible with other solvents, and are uniquely water soluble.

- New thermoplastic polymer blends, including light-stable formulations for rugged applications such as under-sea oil and gas drilling components, high-impact, flame-retardant materials for electronics applications, and a new high-impact plastic polyblend designed for use in the huge automotive body panel market.
- A new family of low-foaming, high detergency surfactants for household and industrial uses based on an organic synthesis technology developed by GAF.
- Improved grades of Gaflex® thermoplastic elastomers, including a more flexible, blow-molding grade and a heat-stabilized version for automotive applications such as protective component coverings. These new customized plastics systems provide opportunities in other expanding market sectors as well.

GAF has also undertaken extensive development work in the biopharmaceutical area in connection with a number of new products and applications, and is developing newer technologies and product lines, based on proprietary GAF chemistry, which offer exciting opportunities for growth. Moreover, these potential markets can easily be exploited by GAF because of the Company's combination of chemical expertise, application development skills, and strong technical service and marketing orientation:

■ GAF is already a major factor in the pharmaceutical industry, where its Plasdone acetylene-based polymers have found increasing application as components in the controlled release of medication. Contributing to GAF's strong presence in the pharmaceutical area are its surfactants, which are under active study in a number of laboratories as potentially significant viricides.

■ New controlled-release systems are in the developmental stage at GAF as well. These include materials as carriers or complexing agents for antibiotics and anti-tumor medicinals, a new application which capitalizes on the unusual ability of these substances to solubilize a variety of normally insoluble drugs for effective treatment of diseases.

■ GAF has developed a new class of specialty acetylenic-based molecules, designed for use not only as processing aids in the biosynthesis of complex drugs but so also as carriers for normally insoluble active ingredients in connection with cosmetic and agricultural applications.

A fully equipped cosmetic salon, permitting the design, evaluation and final testing of newly developed hair care and skin care products.

In a wholly separate area, GAF has developed a non-silver imaging technique that affords high resolution photographs directly from electron beam signals. This processless, dry system is designed for applications where rapid printout of data is an important consideration, such as seismic exploration and business communications.



*More homeowners are
switching to GAF's premium Timberline shingles to
enhance the appearance and value of their homes.*

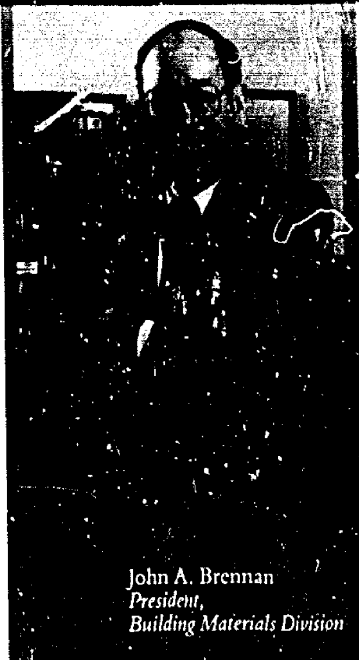
The Building Materials Division posted its second consecutive year of sharply improved profits, with Division income increasing 85% to \$20.1 million from \$10.9 million in 1984. 1985's profit performance represented the Division's best year since 1979. Sales in 1985, reflecting lower prices for the Company's products, were \$363.9 million versus \$370.8 million in the previous year.

The continued turnaround in the profitability of the Building Materials Division was attributable to an improved product mix, expanded product lines, and manufacturing efficiencies. The significant improvement in the Division's performance was achieved notwithstanding severe competitive pressures in the industry, which continued to exert downward pressure on prices throughout most of the year.

Acquisition of Glass Fiber Business

Acquisition of Reichhold Chemicals' Glass Fiber Division in 1985 was an important step in GAF's strategic plan to achieve vertical integration of its roofing manufacturing operations. The acquisition included manufacturing and research and development facilities in Nashville, Tennessee and Irwindale, California, which are now exclusively devoted to the production of chopped glass fiber for mat substrate used in the Company's roofing products. The Reichhold acquisition was designed to ensure increased control over the Division's manufacturing costs as well as to enhance GAF's reliability as a supplier. With its own captive supply of glass fiber, glass mat, and roofing granules, GAF is now the most fully integrated roofing manufacturer in the industry.

GAF completed during the past year a substantial capital spending program, which included not only an expansion of its manufacturing facility in Fontana, California but the



John A. Brennan
President,
Building Materials Division

implementation of improved manufacturing facilities at the Division's thirteen manufacturing facilities. As a result of this capital program and the Division's extensive effort to substantially reduce its cost of production, GAF has become one of the lowest cost producers of any major participant in the industry.

Residential Roofing

Increased sales of GAF's residential roofing products in 1985 resulted from higher re-roofing demand as well as the healthy pace of new home construction, both of which benefited from lower interest rates.

The Company's performance was highlighted by record demand for

Timberline®, GAF's premium roofing product. Timberline shingles are a three-dimensional, laminated product offering a Class A fire rating and a 30-year limited warranty. GAF has accelerated its marketing efforts to reinforce Timberline's position as the industry's "top of the market" product. As a result, dealers, contractors, and architects are recommending Timberline, and an increasing number of homeowners are switching to Timberline as a replacement roofing product in order to improve the appearance, and enhance the value, of their homes.

Royal Sovereign®, GAF's newest residential roofing product, experienced increased customer demand during the year. Royal Sovereign, a durable residential shingle, is designed to capitalize on the "middle market" for quality shingles at a just slightly higher price than standard shingles. This new high-performance, designer-created product has already experienced rapidly increasing sales and is expected to be a more substantial profit contributor in 1986. This exciting new product is offered in a wide range of colors and features a 25-year limited warranty.



Timberline, Royal Sovereign and Sentinel Self-Sealing shingles represent GAF's leading edge products for the residential roofing market.

mat manufacturing line at GAF's ter, South Carolina, ng products plant.



Packaged asphalt is produced at the Company's roofing products plant in Tampa, Florida.

expansion of the GAF Finance program contributed to the Company's 1985 sales improvement. This innovative plan enables customers purchasing Timberline and other GAF products to obtain prompt and favorable home improvement loans on competitive terms. In addition to its favorable impact on sales, the GAF Finance Program has enabled GAF to strengthen its relationships with roofing contractors across the country.

Commercial Roofing

Gafglas® Ply 4 continued to gain acceptance by roofing contractors because of the product's superior handling characteristics and its improved performance. Higher sales were recorded by #75 Gafglas® Base, an asphalt-coated glass fiber product used as an underlayment for large, flat commercial roofs, which was introduced into the market in 1984. As a result of the expansion of production capacity at GAF's Fontana, California facility, it is expected that the Company will be in a position to increase its share of the commercial roofing market for the California region in the coming year.



New Product Lines

GAF developed and brought to market in the latter part of 1985 Ruberoid MB®, a modified bitumen single-ply roofing system. This exciting new addition to GAF's line of commercial roofing products offers the advantages of improved flexibility, ease of application, and cost efficiency. The development marks the sharply increased commitment on the part of GAF to establish itself as the premier supplier of commercial roofing products. Ruberoid MB is being

marketed this year through a promotional campaign featuring the theme of Ruberoid's 100th anniversary, the long-established Ruberoid roofing business having been acquired by GAF in 1967.

Research and Development

The Division's research and development department played an ever increasing role this past year in its contribution to the increased productive efficiency of GAF's roofing manufacturing facilities and the development of improved methods for the utilization of basic raw materials. In this latter connection, research and development activity focused on new technologies to enhance the performance of glass formulations, glass mat processing, and asphalt coatings.

A significant portion of research and development resources was allocated in 1985 to the development of new and improved products. In addition to Ruberoid MB, GAF's product introductions this past year included:

- A new asphalt-based underlayment for residential shingles with improved vapor transmission and superior dimensional stability characteristics.
- A new modified self-seal adhesive for all GAF shingle products which provides stronger sealing characteristics at a wider range of temperatures, resulting in superior wind resistance.

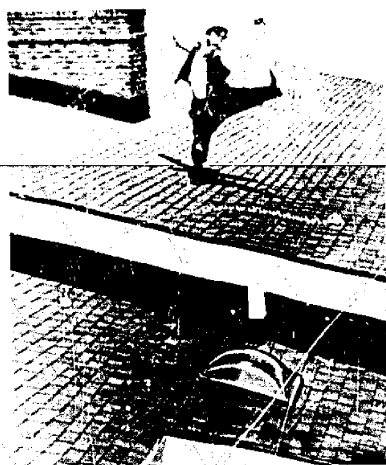
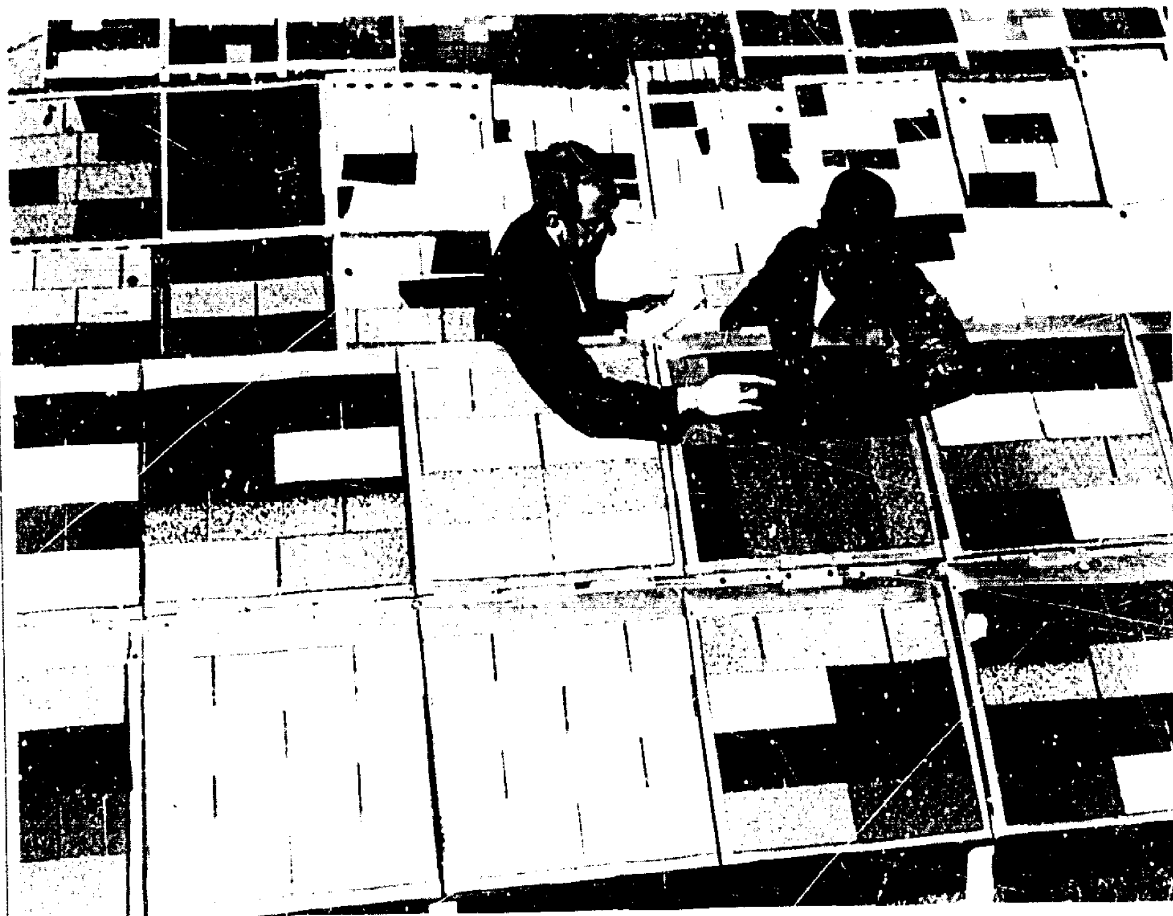
Technology Licensing Program

GAF established a program in 1985 to promote the licensing of GAF's roofing manufacturing technology outside the United States. Under this program, GAF will license its technology for the manufacture of asphalt roofing and related materials, such as glass mat and organic felt, as well as its glass fiber manufacturing technology. GAF's first licensing project involved a fiber glass manufacturing plant located in the Far East.

GAF's leading commercial roofing products include Gafglas Ply 4, #75 Gafglas Base Sheet, Gafglas Stratavent, and Ruberoid MB.



Constant testing of strength and durability under a variety of weather conditions ensures top-flight quality control for GAF's residential roofing shingles.



GAF's new marketing program, in connection with its premium Timberline roofing product, features national advertising based on the theme from the popular musical Fiddler On The Roof.

BUILDING MATERIALS INCOME
(\$ in Millions)



GAF BROADCASTING

Radio station WNCN (104.3-FM) New York, GAF's classical music station, registered an outstanding performance in 1985. Operating income increased by 58% to \$1.1 million on a 12% increase in sales. The station experienced substantially increased business this past year from major advertisers, highlighted by a doubling of advertising revenues from retail and restaurant accounts.

WNCN's sharply improved financial performance reflected continued success of the station's theme, "The Good Life," which was introduced in the fall of 1984. This theme, with its orientation toward upscale listeners in the 25-to-54-age group, has gained for WNCN one of the youngest listening audiences of any classical music station in the United States.

New programs were developed in 1985 to support "The Good Life" theme such as the "Hamptons Report" on the popular New York resort in the summer months and news coverage of ski conditions in the New England area during the winter time. WNCN also strengthened its financial news coverage in 1985. Expanded newsstand distribution of *Keynote*, the station's monthly magazine and program guide, contributed to the effectiveness of WNCN's marketing efforts.

Other 1985 WNCN highlights included:

- WNCN won the Major Armstrong Award administered by Columbia University for excellence in FM broadcasting quality, one of several prestigious awards WNCN has received in recent years.

- WNCN continued to implement program changes designed to broaden the appeal of classical music to larger audiences.



Matthew Field
Vice President
and General Manager,
GAF Broadcasting

- WNCN introduced a new program, "New York Music Magazine," which covers upcoming concerts in the metropolitan area through a magazine-style format.

- WNCN developed a new "Lincoln's Music in America" concert series sponsored by the Ford Motor Company's Lincoln Division, while continuing the popular Chicago Symphony broadcasts and "AT&T Presents Carnegie Hall Tonight" series.

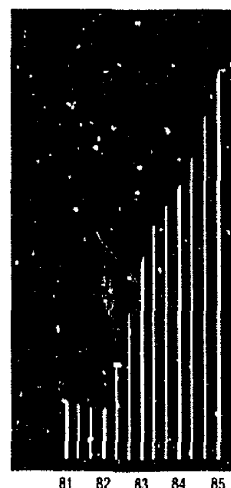
- WNCN inaugurated a unique series of celebrity disc jockey programs, hosted by such well-known figures of the musical world as Beverly Sills and Kiri Te Kanawa.

- WNCN continued as the flagship station of the Concert Music Network, serving as the only New York station to be represented by Concert Music Broadcast Sales, the nation's only all-classical sales representative.

- WNCN staged on-the-air ticket selling events to benefit both Carnegie Hall and the New York City Opera Company.

- WNCN continued to broadcast live concerts from its own performance studio, as well as recorded performances from the Waterloo Festival in New Jersey, the Caramoor Festival in New York's Westchester County, and the "Young Concert Artists" series at the 92nd Street "Y" in Manhattan.

GAF BROADCASTING INCOME
(\$ in Thousands)



WNCN's innovative programming, coupled with a successful new marketing theme, "The Good Life," has gained the station one of the youngest audiences of any classical music station in the United States.



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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GAF Corporation

Financial Condition

Record earnings and significant increases in cash flow from operations substantially improved the Company's financial condition during 1985. The Company's cash flow from operations improved an additional \$20 million (25%) in 1985 to \$100.3 million after a \$38.5 million (92%) increase in 1984. Total working capital increased \$36.4 million (26%) to \$177.1 million after a \$47.5 million (51%) jump in 1984, while total assets increased \$426.5 million (94%) in 1985 to \$879.2 million.

The increased asset base in 1985 principally reflects the Company's \$405.4 million investment in 6,728,000 shares of Union Carbide common stock. See Note 5 to Consolidated Financial Statements. The Company has pre-tax realized and unrealized gains, after expenses, of approximately \$175 million from this investment based on market prices as of February 28, 1986.

In June 1985, the Company issued \$150 million in 11 1/8% senior subordinated notes. This financing and other new industrial revenue bonds issued during 1985 increased the Company's percent of debt to debt plus equity, from 39.4% at December 31, 1984, to 55.7% in 1985. As a result, interest expense was \$19.8 million in 1985 as compared with \$9.1 million in 1984. However, the added interest expense was more than offset by \$22.4 million in investment income.

The Company has a \$50 million revolving credit facility and additional short-term lines of credit, of which approximately \$23 million and \$67.5 million, respectively, were unused at December 31, 1985. See Note 6 to Consolidated Financial Statements.

The Company in 1985 called for redemption all of its outstanding shares of \$1.20 convertible preferred stock. Shareholders converted 2,324,553 shares of preferred stock into 2,905,144 shares of common stock, and the Company redeemed 111,033 shares of preferred stock at a price of \$27.50 plus accrued dividends.

The Company, on May 10, 1985, acquired glass fiber manufacturing facilities in Nashville, Tennessee and Irwindale, California from Reichhold Chemicals, Inc. for \$9.25 million. The Company is now using these facilities to manufacture chopped glass fiber for mat substrate used in

GAF's roofing products. As a result of this acquisition, GAF has become the most fully integrated roofing manufacturer in the industry, with a capax supply of glass mat, roofing granules, and now glass fiber. Financing for the acquisition and related subsequent capital expansion programs was obtained from the issuance of two industrial revenue bonds in the aggregate amount of \$13.5 million, with interest rates at substantially less than the prime rate.

The Company's capital expenditures increased significantly in 1985 to \$47.2 million, as compared with \$17.9 million in 1984. The increased capital outlays were part of the \$118 million capital expansion program announced in the fourth quarter of 1984 to substantially increase production capacity at several of the Company's domestic and foreign operations.

The capital expenditure program in 1986 will be financed from the proceeds of the industrial revenue bonds, internal cash flow and outside bank borrowings as necessary. As of the end of 1985, the Company had commitments of \$9.4 million for approved capital expenditures. Commitments under various capital and operating lease obligations are detailed in Note 11 to Consolidated Financial Statements.

Results of Operations

GAF in 1985 recorded the highest earnings in its history, both in terms of net income and income before extraordinary credits. The \$54.3 million income before extraordinary credits was 32% higher than the previous high of \$41 million set in 1984, and represented an \$83.5 million swing from a loss of \$29.2 million in 1983. Operating income from the Chemicals Division and GAF Broadcasting reached record levels, while the Building Materials Division recorded its best year since 1979.

Division income improved more than 25% in 1985 to \$113.8 million, reflecting a 17% increase in Chemicals profits from \$79 million to \$92.6 million, an 85% increase in Building Materials profits from \$10.9 million to \$20.1 million, and a 58% increase in GAF Broadcasting profits from \$0.7 million to \$1.1 million. Division income in 1984 had nearly tripled over 1983 levels to \$90.6 million as a result of 22% higher Chemicals profits and a \$45.4 million turnaround in Building Materials to a profit of \$10.9 million.

Consolidated sales increased slightly in 1985 to \$732 million after increases of \$31.9 million (4.6%) in 1984 and \$76.2 million (12.2%) in 1983. Chemicals sales were up \$7.2 million (2%) in 1985, reflecting higher unit sales and increased market penetration for all major product lines, after a 1984 sales increase of \$34 million (10.5%). Building Materials sales of \$363.9 million were lower by \$6.9 million (2%) in 1985, reflecting a substantial increase in residential roofing unit sales being more than offset by reduced selling prices, resulting from the industry's continuing competitive pricing structure, and lower unit sales of commercial roofing and insulation. Sales were \$370.8 million in 1984 and \$373.2 million in 1983.

Consolidated operating income for 1985 of \$87.9 million represents an increase of 41% from last year's \$62.2 million and a \$60.1 million (216%) improvement over 1983 operating income of \$27.8 million. Gross profit margin, which was 20.7% in 1983, increased to 24.9% and 29.8% in 1984 and 1985, respectively, as a result of cost control measures implemented by new management in 1984.

The Chemicals Division reported record high profits in 1985 of \$92.6 million, a 17% increase over the previous high of \$79 million for the year 1984 which, in turn, was 22% higher than 1983 results. Operating margins in 1985, 1984 and 1983 were 25.4%, 22.1% and 20%, respectively. The Division continued to show an increasingly high pre-tax operating return on assets, with a return of 42.6%, 38.8% and 32.6%, respectively, for the years 1985, 1984 and 1983.

The Chemicals Division's record performance resulted from increased manufacturing efficiencies, the continuation of a rigid cost control program, and higher unit sales in all major product lines. The Division's international operations made an important contribution to this strong performance, despite the continued strength of the U.S. dollar throughout most of the past year, reporting higher sales and improved profits. International sales increased 3.4% in 1985 after an increase of 12.7% in 1984, while profits, which include GAF's 50% equity in its joint venture manufacturing operation, increased 17.3% in 1985 and 3% in 1984 as compared with 1983.

In two years, the Building Materials Division has recorded a \$54.6 million swing in operating results to a profit of \$20.1 million in 1985, up 85% from \$10.9 million in 1984, and from a loss of \$34.5 million in 1983. This performance has been achieved through major cost cutting and production efficiency programs. The Division has benefited from increased sales volumes in residential roofing, a more favorable product mix as a result of increased sales of Timberline® and Royal Sovereign®, the closing of three unprofitable plants in 1984, and the effect of full conversion in 1984 from organic to glass fiber roofing production. The programs described have enabled GAF to become one of the lowest cost producers in the industry. After three consecutive years of losses in 1981-1983, this turnaround has enabled the Division to show pre-tax operating returns on assets of 10.4% and 6.9% in 1985 and 1984, respectively. Management expects this Division to operate at increasingly higher levels of profitability in the coming year.

Corporate operating expenses were reduced by \$3.1 million (16.8%) in 1985, after a decrease of \$4.2 million (18.5%) in 1984 as compared with 1983. These reductions were attributable to programs implemented in 1984 to decentralize operations, reduce corporate staffs, and relocate the Company's corporate headquarters. Interest expense was \$19.8 million in 1985 as compared with \$9.1 million in 1984 and \$16.3 million in 1983. The increase in 1985 primarily reflects the debt service on the Company's senior subordinated notes which were issued in 1985, as well as borrowings in connection with the Company's investment program. The added interest expense was more than offset by \$22.4 million in income on investments, as detailed in Note 5 to Consolidated Financial Statements.

For a review of the effects of inflation on the Company's financial statements, see Supplementary Data-Financial Reporting and Changing Prices.

REVIEW OF CONSOLIDATED FINANCIAL INFORMATION

GAF Corporation

Summary of Selected Financial Data

(Millions of Dollars, Except Per Share Amounts)

| Year Ended December 31 | 1985 | 1984 | 1983 | 1982 | 1981 |
|---|--------------|--------------|---------------|--------------|---------------|
| Net Customer Sales | | | | | |
| Chemicals | \$364.4 | \$357.2 | \$323.2 | \$294.4 | \$300.8 |
| Building Materials | 363.9 | 370.8 | 373.2 | 328.8 | 371.7 |
| Broadcasting | 3.7 | 3.3 | 3.0 | — | — |
| Consolidated Sales | 732.0 | 731.3 | 699.4 | 623.2 | 672.5 |
| Division Income (Loss) | | | | | |
| Chemicals | 92.6 | 79.0 | 64.6 | 55.4 | 55.9 |
| Building Materials | 20.1 | 10.9 | (34.5) | (26.3) | (38.6) |
| Broadcasting | 1.1 | 0.7 | 0.5 | — | — |
| Total | 113.8 | 90.6 | 30.6 | 29.1 | 17.3 |
| Income (Loss) From Continuing Operations | 54.3 | 41.0 | (29.2) | 12.2 | (28.2) |
| Earnings (Loss) Per Common Share— | | | | | |
| Continuing Operations before Extraordinary Credits: Primary | 3.14 | 2.62 | (2.23) | .64 | (2.24) |
| Fully Diluted | 3.01 | 2.30 | (2.23) | .70 | (1.57) |
| Dividends Per Common Share | .20 | .10 | .05 | .50 | .80 |
| As of December 31 | | | | | |
| Current Assets | \$428.7 | \$254.9 | \$220.9 | \$212.4 | \$337.3 |
| Current Liabilities | 251.6 | 114.2 | 127.7 | 123.4 | 179.6 |
| Working Capital | 177.1 | 140.7 | 93.2 | 89.0 | 157.7 |
| Marketable Securities | 202.2 | — | — | — | — |
| Property, Plant and Equipment—net | 194.1 | 159.1 | 164.5 | 192.4 | 196.4 |
| Total Assets | 879.2 | 452.3 | 414.3 | 468.3 | 559.8 |
| Short-term Debt | 115.4 | 6.5 | 30.7 | 7.8 | 17.4 |
| Total Long-term Debt | 259.0 | 82.8 | 88.8 | 157.1 | 215.6 |
| Shareholders' Equity | 298.2 | 214.0 | 169.8 | 181.9 | 134.7 |
| Percent of Debt to Debt Plus Equity | 55.7% | 29.4% | 41.3% | 47.5% | 63.4% |

Market for Common Stock

As of February 28, 1986, the common stock price was \$67¹/₄, and there were 22,368 holders of record of GAF's outstanding common stock. The following information pertains to the Company's common stock, which is traded on the New York Stock Exchange.

| Cash Dividends Per Common Share | | | Price Range of Common Stock | | | | |
|---------------------------------|-------------------|------|-----------------------------|----------------------------------|----------------------------------|----------------------------------|--------------------------------|
| | 1985 | 1984 | | 1985 | | 1984 | |
| | | | | <u>High</u> | <u>Low</u> | <u>High</u> | <u>Low</u> |
| First Quarter | \$0 ⁰⁰ | \$ — | First Quarter | \$31 ³ / ₈ | \$24 ¹ / ₄ | \$17 ³ / ₄ | \$15 |
| Second Quarter | .05 | — | Second Quarter | 35 ⁷ / ₈ | 29 ¹ / ₂ | 18 ⁷ / ₈ | 15 ¹ / ₂ |
| Third Quarter | .05 | .05 | Third Quarter | 37 ⁷ / ₈ | 29 ⁵ / ₈ | 24 ¹ / ₈ | 17 ⁵ / ₈ |
| Fourth Quarter | .05 | .05 | Fourth Quarter | 70 | 36 | 25 ³ / ₄ | 21 |

CONSOLIDATED STATEMENTS OF INCOME

GAF Corporation

| <i>(Thousands of Dollars, Except Per Share Amounts)</i> | | | |
|--|------------------|-------------------|-------------------|
| <i>Year Ended December 31</i> | 1985 | 1984 | 1983 |
| Net Sales | \$731,962 | \$ 731,314 | \$699,397 |
| Costs and Expenses: | | | |
| Cost of Products Sold | 513,813 | 548,967 | 554,876 |
| Selling, General and Administrative | 130,206 | 120,139 | 116,703 |
| Total Costs and Expenses | 644,019 | 669,106 | 671,579 |
| Operating Income | 87,943 | 62,208 | 27,818 |
| Interest Expense | (19,799) | (9,143) | (16,280) |
| Income on Investments (Note 5) | 22,438 | 4,151 | 3,531 |
| Other Expense—net (Note 2) | (3,108) | (2,598) | (39,258) |
| Income (Loss) Before Income Taxes and Extraordinary Credits | 87,474 | 54,618 | (24,189) |
| Income Taxes (Note 3) | 33,178 | 13,572 | 5,010 |
| Income (Loss) Before Extraordinary Credits | 54,296 | 41,046 | (29,199) |
| Extraordinary Credits (Notes 3 & 4) | 23,285 | 15,656 | 25,358 |
| Net Income (Loss) | \$ 77,581 | \$ 56,702 | \$ (3,841) |
| Earnings Per Common Share (Note 1): | | | |
| Primary: | | | |
| Before Extraordinary Credits | \$ 3.14 | \$ 2.62 | \$ (2.23) |
| Extraordinary Credits | 1.36 | 1.08 | 1.76 |
| Net Income (Loss) | \$ 4.50 | \$ 3.70 | \$ (.47) |
| Fully Diluted: | | | |
| Before Extraordinary Credits | \$ 3.01 | \$ 2.30 | \$ (2.23) |
| Extraordinary Credits | 1.29 | .87 | 1.76 |
| Net Income (Loss) | \$ 4.30 | \$ 3.17 | \$ (.47) |

See Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

GAF Corporation

| <i>(Thousands of Dollars)</i> | | |
|--|------------------|------------------|
| December 31 | 1985 | 1984 |
| Assets | | |
| Current Assets | | |
| Cash | \$ 7,862 | \$ 16,186 |
| Short-term investments (Note 5) | 209,298 | 53,367 |
| Accounts receivable, less reserve: 1985—\$5,142; 1984—\$5,426 | 109,580 | 95,139 |
| Inventories (Note 1) | 94,007 | 83,452 |
| Other current assets | 7,966 | 6,758 |
| Total Current Assets | 428,713 | 254,902 |
| Marketable Securities (Note 5) | 202,229 | — |
| Property, Plant and Equipment—net (Note 1) | 194,086 | 159,115 |
| Other Assets | 54,146 | 38,256 |
| Total Assets | \$879,174 | \$452,273 |
| Liabilities and Shareholders' Equity | | |
| Current Liabilities | | |
| Short-term debt (Note 6) | \$115,380 | \$ 6,461 |
| Current maturities of long-term debt (Note 6) | 10,132 | 10,278 |
| Accounts payable | 57,411 | 57,868 |
| Accrued liabilities | 58,924 | 36,562 |
| Income taxes payable | 9,785 | 2,994 |
| Total Current Liabilities | 251,632 | 114,163 |
| Long-term Debt Less Current Maturities (Note 6) | 248,853 | 72,478 |
| Other Liabilities | 80,536 | 51,626 |
| Shareholders' Equity (Notes 7 & 8) | | |
| Preferred stock, \$1 par value per share: authorized 6,000,000 shares; \$1.20 convertible series; issued shares: 1984—2,539,658; at assigned value of \$1.25 per share | — | 3,175 |
| Common stock, \$1 par value per share: authorized 25,000,000 shares; issued shares: 1985—17,877,589; 1984—14,508,987 | 17,878 | 14,509 |
| Additional paid-in capital | 60,836 | 56,420 |
| Retained earnings | 229,586 | 156,123 |
| Accumulated translation adjustment | (6,135) | (10,451) |
| Treasury stock, at cost | (4,012) | (5,770) |
| Shareholders' Equity | 298,153 | 214,006 |
| Total Liabilities and Shareholders' Equity | \$879,174 | \$452,273 |

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

GAF Corporation

| | | | |
|--|------------------|-----------------|-------------------|
| <i>(Thousands of Dollars)</i> | | | |
| <i>Year Ended December 31</i> | | | |
| | 1985 | 1984 | 1983 |
| Cash and Short-term Investments, January 1 | \$ 69,553 | \$23,468 | \$12,377 |
| Source (Use) of Funds: | | | |
| Income (Loss) Before Extraordinary Credits | 54,296 | 41,046 | (29,199) |
| Charges (credits) not affecting funds: | | | |
| Depreciation | 17,366 | 19,397 | 21,469 |
| Plant shutdown costs | — | — | 26,146 |
| Other—net | 5,308 | 4,209 | (1,937) |
| Total funds from operations before extraordinary credits | 76,970 | 64,652 | 16,479 |
| Extraordinary Credits | 23,285 | 15,656 | 25,358 |
| Total funds from operations | 100,255 | 80,308 | 41,837 |
| Additions to property, plant and equipment | (47,161) | (17,900) | (13,904) |
| Acquisition of glass fiber facilities | (9,250) | — | — |
| Other working capital items* | 2,492 | 24,024 | (6,540) |
| Other | 16,149 | (1,824) | 37,240 |
| Total source before financing and investment activity | 62,485 | 84,608 | 58,633 |
| Financing and investment activity: | | | |
| Increase (decrease) in short-term debt | 108,919 | (24,285) | (10,554) |
| Increases in long-term debt | 195,800 | 6,325 | 62 |
| Decreases in long-term debt | (19,571) | (12,407) | (34,800) |
| Investment in marketable securities | (202,229) | — | — |
| Cash dividends | (4,118) | (4,393) | (3,686) |
| Other | 6,321 | (3,763) | 1,436 |
| Total source (use) from financing and investment activity | 85,122 | (38,523) | (47,542) |
| Increase in cash and short-term investments | 147,607 | 46,085 | 11,091 |
| Cash and Short-term Investments, December 31 | \$217,160 | \$69,553 | \$23,468 |
| *Other working capital items: | | | |
| | 1985 | 1984 | 1983 |
| Accounts receivable | \$(14,441) | \$ 3,027 | \$(12,497) |
| Inventories | (10,555) | 7,299 | 4,028 |
| Other current assets | (1,208) | 1,759 | 4,724 |
| Accounts payable | (457) | 11,859 | (4,744) |
| Accrued liabilities | 22,362 | (630) | 1,057 |
| Income taxes payable | 6,791 | 710 | 892 |
| Net source (use) of funds | \$ 2,492 | \$24,024 | \$ (6,540) |

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

GAF Corporation

| (Thousands of Dollars) | | | |
|---|------------------|------------------|------------------|
| Year Ended December 31 | | | |
| | 1985 | 1984 | 1983 |
| \$1.20 Convertible Preferred Stock: | | | |
| Balance, January 1 | \$ 3,175 | \$ 3,187 | \$ 3,194 |
| Converted into common stock: 1985—2,428,625 shares; 1984—9,740 shares; 1983—5,359 shares | (3,036) | (12) | (7) |
| Redemption of preferred stock—111,033 shares | (139) | — | — |
| Balance, December 31 | — | 3,175 | 3,187 |
| Common Stock, \$1 Par Value Per Share: | | | |
| Balance, January 1 | 14,509 | 14,466 | 14,459 |
| Conversion of preferred stock and 5% convertible subordinated notes | 3,369 | 43 | 7 |
| Balance, December 31 | 17,878 | 14,509 | 14,466 |
| Additional Paid-in Capital: | | | |
| Balance, January 1 | 56,420 | 55,548 | 55,008 |
| Conversion of 5% convertible subordinated notes | 7,167 | 669 | — |
| Redemption of preferred stock | (2,888) | — | — |
| Excess of proceeds over cost of treasury common stock sold | 13 | 128 | 484 |
| Other | 124 | 75 | 56 |
| Balance, December 31 | 60,836 | 56,420 | 55,548 |
| Retained Earnings: | | | |
| Balance, January 1 | 156,123 | 103,814 | 111,341 |
| Net Income (Loss) | 77,581 | 56,702 | (3,841) |
| Cash dividends: | | | |
| Preferred stock (per share: 1985—\$.30; 1984 and 1983—\$.20) | (748) | (2,958) | (2,970) |
| Common stock (per share: 1985—\$.20; 1984—\$.10; 1983—\$.05) | (3,370) | (1,435) | (716) |
| Balance, December 31 | 229,586 | 156,123 | 103,814 |
| Accumulated Translation Adjustment: | | | |
| Balance, January 1 | (10,451) | (6,080) | — |
| Accounting change at January 1, 1983 | — | — | (1,903) |
| Translation adjustment for the year | 4,316 | (4,371) | (4,177) |
| Balance, December 31 | (6,135) | (10,451) | (6,080) |
| Treasury Stock, at cost: | | | |
| \$1.20 Convertible preferred stock: | | | |
| Balance, January 1 | (1,657) | (932) | (932) |
| Repurchase of odd-lot holdings—27,272 shares | — | (725) | — |
| Converted into common treasury shares—103,672 shares | 1,657 | — | — |
| Balance, December 31: 1984—103,672 shares; 1983—76,400 shares | — | (1,657) | (932) |
| Common stock: | | | |
| Balance, January 1 | (4,113) | (199) | (1,151) |
| Repurchased under restricted stock purchase plan: | | | |
| 1984—20,928 shares; 1983—24,013 shares | — | (136) | (152) |
| Issued under various stock option and stock purchase plans: | | | |
| 1985—99,212 shares; 1984—81,569 shares; 1983—144,750 shares | 1,758 | 1,062 | 1,104 |
| Repurchase of odd-lot holdings—233,073 shares | — | (4,840) | — |
| Conversion of preferred stock in treasury—129,590 shares | (1,657) | — | — |
| Balance, December 31: 1985—226,820 shares; 1984—196,442 shares; 1983—24,010 shares | (4,012) | (4,113) | (199) |
| Shareholders' Equity | \$298,153 | \$214,006 | \$169,804 |

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

GAF Corporation

1. Summary of Significant Accounting Policies

Principles of Consolidation

The accounts of all significant subsidiaries of the Company are included in the consolidated financial statements. All significant intercompany transactions and balances have been eliminated. A wholly owned captive insurance subsidiary and the 50 percent ownership of a foreign chemical manufacturing company are accounted for by the equity method.

Short-term Investments and Marketable Securities

Short-term investments and marketable securities are stated at cost. (See Note 5).

Inventories

Inventories are stated at the lower of cost (principally average) or market. Inventories at December 31 consist of the following:

| Thousands of Dollars | 1985 | 1984 |
|----------------------------|----------|----------|
| Finished goods | \$49,748 | \$40,296 |
| Work in process | 16,440 | 12,891 |
| Raw materials and supplies | 27,819 | 30,265 |
| Total inventories | \$94,007 | \$83,452 |

Property, Plant and Equipment and Related Depreciation

Depreciation is computed principally on the straight-line method based on the estimated economic lives of the assets. Certain interest charges are capitalized as part of the cost of property, plant and equipment additions.

Property, Plant and Equipment at December 31 consist of the following:

| Thousands of Dollars | 1985 | 1984 |
|-----------------------------------|-----------|-----------|
| Land and land improvements | \$ 16,760 | \$ 15,049 |
| Buildings and building equipment | 53,631 | 52,558 |
| Machinery and equipment | 226,387 | 200,658 |
| Construction in progress | 11,362 | 10,182 |
| Total | 308,140 | 278,447 |
| Less Accumulated Depreciation | 114,054 | 119,332 |
| Property, Plant and Equipment—net | \$194,086 | \$159,115 |

Deferred Income Taxes

Deferred income taxes arise from reporting certain income and expense items in the financial statements in periods different from those in which such amounts are reported for income tax purposes.

Investment Tax Credits

The Company accounts for investment tax credits as a reduction of the provision for United States income tax (the flow-through method).

Research and Development

Research and development expenses are charged to operations as incurred and amounted to \$10.4 million in 1985, \$8.7 million in 1984 and \$8.0 million in 1983.

Earnings Per Common Share

Primary earnings per common share are based on the weighted average number of common and common equivalent shares outstanding during each year after giving appropriate effect for preferred stock dividends. Weighted average shares for computing primary earnings per share were (in thousands) 17,171 for 1985, 14,510 for 1984 and 14,442 for 1983.

Fully diluted earnings per share are based on the weighted average number of common and common equivalent shares outstanding and the assumed conversion of convertible securities outstanding after appropriate adjustment for interest on convertible notes. Where the effect of the assumed conversion on net income would be anti-dilutive, primary and fully diluted earnings per share are stated the same. Weighted average shares for computing fully diluted earnings per share were (in thousands) 18,047 for 1985, 17,993 for 1984 and 17,907 for 1983.

2. Other Expense

A summary of Other Expense—net follows:

| Thousands of Dollars Year ended December 31 | 1985 | 1984 | 1983 |
|--|-----------|-----------|------------|
| Equity method income | \$ 4,268 | \$ 5,125 | \$ 4,705 |
| Plant shutdown costs | — | — | (26,146) |
| Proxy contest and related expenses | — | — | (10,042) |
| Adjustment of insurance accruals | (4,438) | (2,400) | — |
| Office relocation expenses | — | — | (3,488) |
| Miscellaneous—net | (2,938) | (5,323) | (4,287) |
| Other Expense—net | \$(3,108) | \$(2,598) | \$(39,258) |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Equity Method Income and Net Assets

Financial data for investments which are accounted for by use of the equity method follows:

| Thousands of Dollars Year ended December 31 | 1985 | | 1984 | |
|--|-------------------|---------------------------------|-------------------|---------------------------------|
| | Joint Venture* | Captive Insurance Subsidiary | Joint Venture* | Captive Insurance Subsidiary |
| Income Statement Data | | | | |
| Revenues | \$46,417 | \$ 3,403 | \$45,613 | \$3,125 |
| Costs and Expenses | 36,548 | 2,273 | 35,102 | 1,834 |
| Operating Income | 9,869 | 1,130 | 10,511 | 1,291 |
| Income for the Year | 5,445 | 1,130 | 6,735 | 1,291 |
| GAF Equity Therein | 3,138 | 1,130 | 3,834 | 1,291 |
| December 31 Balance Sheet Data | | | | |
| Current Assets | \$ 9,298 | \$ 3,307 | \$18,997 | \$2,088 |
| Noncurrent Assets | 36,897 | 9,525 | 12,501 | 7,522 |
| Total Assets | 46,195 | 12,832 | 31,498 | 9,610 |
| Current Liabilities | 13,263 | 28 | 9,615 | 38 |
| Noncurrent Liabilities | 5,111 | 7,470 | 1,175 | 4,918 |
| Total Liabilities | 18,374 | 7,498 | 10,790 | 4,956 |
| Net Assets | 27,821 | 5,334 | 20,708 | 4,654 |
| GAF Equity Therein | 13,052 | 5,334 | 8,898 | 4,654 |

*Joint Venture data presented above pertains to CAF/Hüls Chemie GmbH, a joint venture between GAF Corporation and Chemische Werke Hüls, which operates a chemical manufacturing plant in West Germany.

3. Income Taxes

Income Taxes consist of the following:

| Thousands of Dollars Year ended December 31 | 1985 | 1984 | 1983 |
|--|----------|----------|---------|
| Federal | \$19,684 | \$ 4,932 | \$ — |
| Foreign | 7,882 | 5,835 | 5,310 |
| State | 5,612 | 2,805 | (300) |
| Income Taxes | \$33,178 | \$13,572 | \$5,010 |

The differences between the income tax provision (benefit) computed by applying the statutory federal income tax rate to pre-tax income (loss) and the actual tax provision are as follows:

| Thousands of Dollars Year ended December 31 | 1985 | 1984 | 1983 |
|--|----------|----------|------------|
| Statutory Provision (Benefit) | \$40,238 | \$25,125 | \$(11,127) |
| Adjustments: | | | |
| Operating loss carryforward | — | — | 19,674 |
| Investment tax credits | (3,217) | (10,700) | — |
| Impact of foreign operations | (1,581) | (1,572) | (2,038) |
| State and local taxes | 3,031 | 1,515 | — |
| Other | (5,293) | (796) | (1,499) |
| Income Taxes | \$33,178 | \$13,572 | \$ 5,010 |

At December 31, 1985, the Company had for financial reporting purposes net operating loss carryforwards available to offset future income subject to tax of approximately \$22 million, of which approximately \$20 million relates to domestic operations.

As of December 31, 1985, provision had not been made for United States income taxes on approximately \$20 million of unremitted earnings of consolidated foreign subsidiaries and the Company's 50% owned joint venture, because any United States taxes payable on foreign earnings which may be remitted in the future are expected to be substantially reduced by foreign tax credits.

Extraordinary Credits for 1985, 1984 and 1983 include \$1,576,000, \$1,830,000 and \$3,527,000, respectively, representing the income tax benefit from the utilization of foreign operating loss carryforwards. The 1985 and 1984 Extraordinary Credits also include income tax benefits of \$21,709,000 and \$5,479,000 from the utilization of federal and state operating loss carryforwards. Future utilization of the operating loss carryforwards for financial reporting purposes will require the restoration of applicable deferred income tax amounts.

4. Benefit Plans

In 1982, the Board of Directors of the Company authorized the termination of the Retirement Plan for Salaried Employees (Plan), a defined benefit plan, effective December 31, 1982, and the creation of a new GAF Capital Accumulation Plan, a defined contribution plan, for eligible salaried employees effective January 1, 1983. As a result of the termination, transfers of funds were made to the Company in 1983 and 1984 in the total amount of \$55,178,000. Such reversion of the Plan's residual assets to the Company created Extraordinary Credits of \$8,347,000 and \$21,831,000 for the years 1984 and 1983, respectively.

Under the new GAF Capital Accumulation Plan, Company contributions consist of a basic contribution of three percent of the compensation of participants for the plan year together with matching contributions, up to an additional four percent as specified in the plan, for those participants who have elected to make voluntary contributions to the plan. Each participant is fully vested at all times in the balance in each of his or her accounts in the plan. The aggregate contributions made by the Company to the plan and charged to operations in 1985, 1984 and 1983 were \$3,126,000, \$2,896,000 and \$3,029,000, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The retirement plans for hourly employees and Texas City facility employees are noncontributory defined benefit plans. Company policy is to fund accrued pension expense. Pension expense charged to operations was \$559,000 in 1985, \$289,000 in 1984 and \$430,000 in 1983. A comparison of the accumulated plan benefits and plan net assets for these plans, after giving effect to the spin-off/termination as discussed in the following paragraph, is presented below:

| Thousands of Dollars | 1985 | 1984 |
|---|---------|----------|
| Actuarial present value of accumulated plan benefits: | | |
| Vested | \$1,877 | \$83,625 |
| Nonvested | 502 | 2,461 |
| Total | \$2,379 | \$86,086 |
| Plan assets available for benefits | \$1,216 | \$92,626 |
| Assumed rate of return | 8% | 8% |
| Plan valuation date | 1/1/85 | 1/1/84 |

In 1984, the Company announced a proposed spin-off/termination involving its Retirement Plan for Hourly Employees, pursuant to which the Company purchased an annuity contract approximating \$69.6 million covering the benefits accrued to September 1, 1984, for participants of the plan. Assets were sufficient to provide for the accrued benefits of all hourly participants. Pursuant to governmental regulations, excess assets were then "spun-off" to a new plan for inactive members. The inactive plan was then terminated. Following government approvals of the spin-off/termination, excess assets of \$16.1 million reverted to the Company in November, 1985. An additional \$3.8 million was received and established as a reserve pending final resolution of any plan liabilities. The Company will contribute to the plan in future years for active employees to meet liabilities as they accrue.

In addition to providing pension benefits, the Company and its subsidiaries provide certain health care and life insurance benefits for retired employees. Substantially all of the Company's employees, including employees in foreign countries, may become eligible for those benefits if they reach normal retirement age while working for the Company. The cost of retiree health care and life insurance benefits (\$3.2 million and \$3.7 million in 1985 and 1984, respectively) is recognized as expense as claims are incurred.

As part of the 1977 and 1980 discontinuance programs, the Company provided health and life insurance coverage for certain retired employees of discontinued businesses. The balance of the liability for such future obligations at December 31, 1985 and 1984 was \$16.8 million and \$18 million, respectively.

5. Marketable Securities

During 1985, the Company acquired 6,961,000 shares of Union Carbide (Carbide), or 9.9% of the total outstanding shares, at an average cost of approximately \$51 a share. In December 1985, the Company announced its intention to commence a cash tender offer for all the remaining outstanding shares of Carbide. However, the Company withdrew its tender offer in January 1986, and exchanged 3.5 million shares of Carbide pursuant to Carbide's exchange offer. GAF will report the gain resulting from that transaction in the first quarter of 1986. The Company remains a major Carbide shareholder, retaining 3,228,187 shares or approximately 10.6% of Carbide's outstanding shares, which is classified as Marketable Securities, a non-current asset.

After the sale of 233,000 shares in December, the Company at December 31, 1985, held 6,728,000 shares of Carbide at a total cost of \$405.4 million, including approximately \$60 million in costs relating to the Company's tender offer. At that date, the market value of such shares was \$476.8 million, based on \$70⁷/₈ per share. The cost basis of the 3.5 million shares exchanged in January, \$203.2 million, has been classified as a current asset at December 31, 1985. The remaining \$6.1 million of short-term investments at December 31, 1985, and \$53.4 million at December 31, 1984, are stated at cost which approximates market.

Income on investments for 1985 includes \$8.9 million in net realized gains, \$10.6 million in dividends and \$2.9 million in interest income. Income on investments for 1984 and 1983 represents interest income. The determination of cost in computing realized gains and losses on investments is based on the first-in first-out method.

6. Debt and Dividend Restrictions

Information regarding short-term debt is as follows:

| Thousands of Dollars | 1985 | 1984 | 1983 |
|---|-----------|----------|----------|
| As of December 31: | | | |
| Balance outstanding | \$115,380 | \$ 6,461 | \$30,746 |
| Weighted average interest rate | 8.7% | 8% | 10.7% |
| For the Year: | | | |
| Average month-end short-term debt outstanding | \$ 51,757 | \$17,915 | \$73,931 |
| Maximum month-end short-term debt outstanding | \$118,315 | \$45,789 | \$95,517 |
| Weighted average month-end interest rate | 8.6% | 11.4% | 10.1% |

Of the total short-term debt outstanding at December 31, 1985, \$99.4 million represents margin loans secured by shares of Union Carbide stock. Such loans were repaid in January 1986, with proceeds from the exchange of 3.5 million Carbide shares (see Note 5).

At December 31, 1985, the Company had unused short-term lines of credit aggregating approximately \$67.5 million (in addition to the revolving credit facility discussed below). The short-term lines of credit are maintained with banks on terms which expire on various dates, but are generally renewable. Borrowings generally bear interest at or near the prime commercial lending rate.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Long-term debt at December 31, 1985 and 1984 was as follows:

| Thousands of Dollars | 1985 | 1984 |
|--|-----------|----------|
| 9 1/2% senior notes due March 31, 1987, with annual scheduled principal repayments | \$ 10,600 | \$17,100 |
| 8 1/2% senior notes due January 15, 1992, with annual scheduled principal repayments | 16,700 | 19,300 |
| Revolving credit agreement | 27,000 | — |
| Industrial revenue bonds with various interest rates and maturity dates to 2012. Certain assets are pledged as collateral thereto. | 39,926 | 22,981 |
| Obligation under capital lease (Note 11) | 9,525 | 10,319 |
| 11 3/4% senior subordinated notes due June 15, 1995 | 150,000 | — |
| 5% convertible subordinated notes due April 1, 1994 | — | 7,500 |
| Other | 5,234 | 5,556 |
| Total | 258,985 | 82,756 |
| Less current maturities | 10,132 | 10,278 |
| Long-term debt, less current maturities | \$248,853 | \$72,478 |

The Company has a \$50 million revolving credit facility with a consortium of banks, terminating January 31, 1987. Interest on the borrowings is at the prime rate, a rate based on the London Interbank Offer Rate, or a rate based on the Certificate of Deposit Rate. Under the agreement, a commitment fee is charged on the daily average unused portion of the commitments.

The agreement includes restrictions on the payment of cash dividends on GAF common stock, generally based upon 50% of net income subsequent to April 1, 1984, less all cash dividends and certain other special payments made after April 1, 1984. As of December 31, 1985, \$50.8 million of retained earnings were available under this agreement for such purposes. The agreement and other loan agreements contain provisions which, among other things, require the maintenance of minimum working capital and net worth and limit the amount of debt and capital expenditures, restrict the right to sell capital assets, engage in mergers or consolidations and to incur certain contingent obligations.

The Company in June 1985, issued \$150 million of 11 3/4% senior subordinated notes due June 15, 1995. The notes will be redeemable at the option of the Company after June 15, 1992, at their principal amount plus accrued interest. Interest on the notes will be payable on June 15 and December 15 each year.

The 5% convertible subordinated notes were convertible into shares of common stock at any time at a conversion price of \$22.50 per share. During 1985 and 1984, \$7,500,000 and \$700,000, respectively, of notes were converted into 333,331 and 31,111, respectively, shares of common stock.

The aggregate maturities of long-term debt for the next five years are as follows. Borrowings of \$27 million outstanding under the revolving credit agreement are included in the 1987 amount based on its term.

| Thousands of Dollars | |
|----------------------|----------|
| 1986 | \$10,132 |
| 1987 | 39,860 |
| 1988 | 4,107 |
| 1989 | 6,118 |
| 1990 | 3,985 |

7. Capital Stock

The Company in 1985 called for redemption all of its outstanding shares of \$1.20 convertible preferred stock. Shareholders converted 2,324,553 shares of preferred stock into 2,905,144 shares of common stock, and the Company redeemed 111,033 shares of preferred stock at a price of \$27.50 plus accrued dividends. In addition, the Company converted all 103,672 shares of its \$1.20 convertible preferred stock held in treasury into 129,590 shares of common stock to be held in treasury.

At December 31, 1985, there were 1,896,753 shares of common stock reserved for issuance under the Company's stock option and stock purchase plans.

8. Stock Option and Stock Purchase Plans

In 1984, the Company adopted the 1984 Stock Option Plan which provides for the granting of incentive and nonqualified stock options to key employees of the Company and its subsidiaries to purchase common stock of the Company at not less than 100 percent of the fair market value at the date of grant. Under the terms of the plan, options for 800,000 shares of common stock may be granted from time to time until April 30, 1989. The term of each option is five years and sixty days. Options may not be exercised during the first year after the date of grant, but thereafter, options become exercisable as to 20% of the shares subject thereto on each of the first through the fifth anniversaries of the date of grant.

The Company's 1975 nonqualified stock option plan provided for the granting of 800,000 options to key employees to purchase common stock of the Company at not less than 100 percent of the fair market value at the date of grant. Options granted through April 30, 1984, are exercisable one year after grant and expire after 10 years. Options granted after April 30, 1984, are subject to the same terms and conditions as options issued under the 1984 Stock Option Plan.

These plans provide for stock appreciation rights, wherein an option holder may request "surrender" of the option in exchange for payment (in cash or stock) by the Company of the difference between the option and market prices on the date of surrender. The requested surrender of an option may be granted or denied at the discretion of the Executive Compensation Committee of the Board of Directors. The plans also provide for limited stock appreciation rights permitting the option holder to surrender exercisable options in the event of a tender or exchange offer for the Company's common stock made by someone other than the Company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a summary of certain information pertaining to the 1975 and 1984 stock option plans:

| Shares | 1985 | 1984 | 1983 |
|------------------------------|-----------|-----------|-----------|
| Outstanding January 1 | 675,800 | 254,400 | 404,650 |
| Granted | 92,005 | 400,400 | — |
| Exercised | (58,185) | (52,000) | (144,750) |
| Terminated | (37,520) | (7,000) | (5,500) |
| Outstanding December 31 | 672,100 | 675,800 | 254,400 |
| At December 31 | | | |
| Exercisable | 230,895 | 201,900 | 254,400 |
| Available for grant | 393,595 | 450,200 | 124,000 |
| Option Price Range Per Share | | | |
| Outstanding | \$ 9.625- | \$ 9.625- | \$ 9.625- |
| | \$46.250 | \$23.750 | \$14.875 |
| Exercised | \$ 9.625- | \$ 9.625- | \$ 9.625- |
| | \$23.750 | \$14.875 | \$14.875 |

In April 1984, the shareholders of the Company approved the 1984 Employee Stock Purchase Plan covering 600,000 shares of common stock. The plan provides for

grants of options to purchase shares of common stock on a nondiscriminatory basis to all eligible employees of the Company and its subsidiaries. No options to purchase shares of common stock under the plan may be granted after April 30, 1989. The price at which shares may be purchased is the lesser of (i) 85% of the fair market value on the date of grant or (ii) 85% of the fair market value on the date of purchase. As of December 31, 1985, 46,832 shares of common stock had been issued under the plan.

Under the provisions of the Company's 1969 restricted and unrestricted stock purchase plan, 650,000 shares of common stock were authorized for sale to key employees. The plan currently provides that restricted and unrestricted shares may be sold at prices which are not less than 50 percent and 80 percent, respectively, of the closing market price preceding the date of grant. Under certain conditions, the Company has the right to repurchase restricted shares of common stock at the original selling price. At December 31, 1985, there were 277,890 shares available for sale under this stock purchase plan.

9. Business Segments Information

| Millions of Dollars Year ended December 31 | 1985 | 1984 | 1983 |
|--|---------|---------|-----------|
| Sales | | | |
| Chemicals* | \$364.4 | \$357.2 | \$323.2 |
| Building Materials | 363.9 | 370.8 | 373.2 |
| Broadcasting | 3.7 | 3.3 | 3.0 |
| Consolidated Sales | \$732.0 | \$731.3 | \$699.4 |
| Division Income (Loss) | | | |
| Chemicals** | \$ 92.6 | \$ 79.0 | \$ 64.6 |
| Building Materials | 20.1 | 10.9 | (34.5) |
| Broadcasting | 1.1 | 0.7 | 0.5 |
| Total | 113.8 | 90.6 | 30.6 |
| Corporate: | | | |
| Operating Expenses | (15.4) | (18.5) | (22.7) |
| Interest Expense | (19.8) | (9.1) | (16.3) |
| Other Income (Expense) — net | 8.9 | (8.4) | (15.8) |
| Net Corporate Expenses | (26.3) | (36.0) | (54.8) |
| Income (Loss) Before Income Taxes and Extraordinary Credits | \$ 87.5 | \$ 54.6 | \$ (24.2) |
| Identifiable Assets | | | |
| Chemicals** | \$217.3 | \$203.8 | \$198.1 |
| Building Materials | 194.2 | 158.6 | 164.1 |
| Corporate and other | 467.7 | 89.9 | 52.1 |
| Total Assets | \$879.2 | \$452.3 | \$414.3 |
| Additions to Property, Plant and Equipment | | | |
| Chemicals | \$ 21.5 | \$ 9.6 | \$ 5.2 |
| Building Materials | 24.4 | 8.0 | 8.3 |
| Corporate and other | 1.3 | 0.3 | 0.4 |
| Total | \$ 47.2 | \$ 17.9 | \$ 13.9 |
| Depreciation | | | |
| Chemicals | \$ 10.3 | \$ 11.1 | \$ 10.0 |
| Building Materials | 6.0 | 7.0 | 9.3 |
| Corporate and other | 1.1 | 1.3 | 2.2 |
| Total | \$ 17.4 | \$ 19.4 | \$ 21.5 |

*Chemicals sales are net of intersegment sales of \$27.4 million, \$21.2 million and \$20.9 million for 1985, 1984 and 1983, respectively. Intersegment sales are recorded at the same prices charged to unaffiliated customers.

**Chemicals Division income and identifiable assets include GAF's 50% equity in the income and assets of GAF/Hüls Chemie GmbH (see Note 2).

10. Geographic Information

| Millions of Dollars Year ended December 31 | 1985 | 1984 | 1983 |
|--|---------|---------|---------|
| Domestic Operations: | | | |
| Net Sales* | \$42.9 | \$45.9 | \$52.9 |
| Operating Income | \$ 73.3 | \$ 49.2 | \$ 36.0 |
| Other Income (Expense) | (7.3) | (4.9) | (6.0) |
| Income (Loss) Before Income Taxes and Extraordinary Credits | \$ 66.0 | \$ 34.3 | \$ 30.0 |
| Identifiable Assets | \$826.6 | \$404.8 | \$375.3 |
| Foreign Operations: | | | |
| Net Sales** | \$ 89.1 | \$ 81.4 | \$ 71.5 |
| Operating Income | \$ 14.6 | \$ 15.0 | \$ 11.8 |
| Other Income (Expense)*** | 6.9 | 2.3 | 8.0 |
| Income (Loss) Before Income Taxes and Extraordinary Credits | \$ 21.5 | \$ 17.3 | \$ 19.8 |
| Identifiable Assets*** | \$ 52.6 | \$ 47.5 | \$ 39.3 |

*Domestic sales are net of transfers between geographic areas of \$40.8 million, \$34.9 million and \$29.0 million, respectively.

**Foreign sales are net of transfers between geographic areas of \$10.4 million, \$7.5 million and \$9.4 million, respectively.

***Foreign Operations income and identifiable assets include GAF's 50% equity in the income and assets of GAF Huls Chemie GmbH (see Note 2).

11. Commitments and Contingencies

The lease for the Company's headquarters in Wayne, N.J., is accounted for as a capital lease and is included in Property, Plant and Equipment—net at December 31, 1985 and 1984 in the amount of \$7,106,000 and \$7,546,000, respectively. The related present value of future net minimum lease payments is reflected as long-term debt (see Note 6), and the amortization expense associated with the capital lease is included in depreciation expense. The Company also has operating leases for transportation and data processing equipment and for other buildings.

Future minimum lease payments for properties which are held under long-term noncancelable leases as of December 31, 1985 are as follows:

| Thousands of Dollars Minimum Payments | Capital Lease | Operating Leases |
|--|------------------|---------------------|
| 1986 | \$ 1,544 | \$5,334 |
| 1987 | 1,482 | 1,840 |
| 1988 | 1,419 | 898 |
| 1989 | 1,356 | 714 |
| 1990 | 1,294 | 317 |
| Later Years | 7,306 | — |
| Total minimum payments | 14,401 | \$9,103 |
| Less interest included above | 4,876 | — |
| Present value of net minimum lease payments | \$ 9,525 | — |

At December 31, 1985, there were various lawsuits pending against the Company relating to matters arising from its business, including approximately 23,000 involving bodily injury claims relating to the exposure to asbestos or asbestos-containing products no longer sold by the Company. The Company is also named as a defendant in approximately 76 asbestos property damage lawsuits by school districts and other owners of buildings seeking to recover damages including the cost of removal of asbestos insulation and other asbestos products. The full cost of indemnity and defense of all the asbestos bodily injury and property damage lawsuits is being paid by the Company's insurance carriers, subject to reservations of rights. In the opinion of management, the ultimate disposition of such matters will not have a material adverse effect on the Company's consolidated financial position.

12. Supplementary Financial Information

| Thousands of Dollars Year ended December 31 | 1985 | 1984 | 1983 |
|--|----------|----------|----------|
| Maintenance and repairs | \$31,688 | \$41,796 | \$40,822 |
| Rentals—operating leases | 6,296 | 7,746 | 6,954 |

AUDITORS' REPORT

ARTHUR
ANDERSEN
& CO.

101 Eisenhower Parkway
Roseland, New Jersey 07068

To the Shareholders and Board of Directors of
GAF Corporation:

We have examined the consolidated balance sheets of GAF Corporation (a Delaware corporation) and subsidiaries as of December 31, 1985 and 1984, and the related consolidated statements of income, changes in financial position and shareholders' equity for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The financial statements for the year ended December 31, 1983 were examined by other auditors whose report thereon dated February 17, 1984, expressed an unqualified opinion on those statements.

In our opinion, the financial statements referred to above present fairly the financial position of GAF Corporation and subsidiaries as of December 31, 1985 and 1984, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods and on a basis consistent with that of the preceding year.

Arthur Andersen & Co.

February 10, 1986

SUPPLEMENTARY DATA (Unaudited)

Financial Reporting and Changing Prices

The Company's financial statements are presented on an historical cost basis and, as such, are not intended to measure the effects of changing prices in an inflationary economy. In accordance with the Statement of Financial Accounting Standards No. 33, "Financial Reporting and Changing Prices," as amended, the following supplementary information is presented to reflect the estimated impact of inflation on the Company's income from continuing operations.

The Company's historical financial data have been adjusted for the effects of changes in specific prices (current cost basis) on inventories and property, plant and equipment. Plant and equipment current costs were estimated by adjusting historical costs by externally generated industrial price indexes. Inventory costs were developed using current manufacturing costs. Inventory costs included in the Cost of Products Sold were determined on average current costs during the year. Depreciation expense was adjusted based on the restated asset values using the same estimated

useful lives and depreciation rates used in the primary financial statements.

Adjusted income before extraordinary credits of \$44.8 million for the year ended December 31, 1985, compares to reported earnings of \$54.3 million, reflecting the increased cost of replacing assets during inflationary periods. This hypothetical decrease in income is due to the higher depreciation expense on property, plant and equipment and higher costs of inventories sold. Sales and other costs and expenses, including income taxes, have not been adjusted. This points out the higher tax burden on companies during inflationary periods, as the effective tax rate for GAF on the adjusted income statement is 42.6% compared with a rate of 37.9% on the 1985 historical financial statements.

The management of the Company cautions the reader in interpreting this supplementary data due to the required use of numerous assumptions and estimates in preparing the information. These data are therefore only an indicator of the effects of inflation and do not provide a precise measurement.

Consolidated Statement of Income Adjusted for Changing Prices

| Thousands of Dollars Year Ended December 31, 1985 | As Reported in the Primary Statements (Historical Cost) | Adjusted for Changes in Specific Prices (Current Cost) |
|--|---|---|
| Net Sales | \$731,962 | \$731,962 |
| Cost of Products Sold* | 498,842 | 502,406 |
| Depreciation | 17,366 | 23,340 |
| Other Expenses—net | 108,481 | 108,481 |
| Interest Expense | 19,799 | 19,799 |
| Income Taxes | 33,178 | 33,178 |
| Income Before Extraordinary Credits | \$ 54,296 | \$ 44,758 |
| Purchasing power gain on net monetary liabilities | | \$ 2,548 |
| Increase in specific prices (current cost) of inventories and property, plant and equipment held during the year** | | \$ 5,693 |
| Effect of increase in the general price level | | 12,007 |
| Increase in specific prices over (under) effect of increase in the general price level | | \$ (6,314) |

*Excludes \$14,971 depreciation expense included in Cost of Products Sold in the primary financial statements.

**The estimated current cost of net Property, Plant and Equipment and Inventories was \$248,267 and \$94,824, respectively, at December 31, 1985.

Comparison of Selected Supplementary Financial Data Adjusted for Effects of Changing Prices (In Average 1985 Dollars)

| Thousands of Dollars, Except Per Share Amounts | 1985 | 1984 | 1983 | 1982 | 1981 |
|--|-----------|-----------|-----------|-----------|-----------|
| Net Sales | \$731,962 | \$757,422 | \$755,223 | \$694,653 | \$793,526 |
| Current cost information: | | | | | |
| Income (loss) from continuing operations | 44,758 | 26,840 | (56,109) | (12,235) | (57,662) |
| Income (loss) per common share—primary | 2.59 | 1.64 | (4.10) | (1.08) | (4.37) |
| Increase in specific prices of inventory and property over (under) effect of increase in general price level | (6,314) | 1,434 | (8,450) | 4,353 | (28,966) |
| Net assets at year-end | 347,535 | 286,457 | 265,459 | 300,709 | 274,272 |
| Other data, adjusted for general inflation: | | | | | |
| Purchasing power gain on net monetary liabilities | 2,548 | 1,999 | 3,431 | 6,845 | 25,709 |
| Dividends per common share | .20 | .10 | .05 | .56 | .95 |
| Year-end market price per common share | 58.06 | 25.02 | 17.66 | 15.43 | 16.46 |
| Average Consumer Price Index | 322.2 | 311.1 | 298.4 | 289.1 | 272.4 |

SUPPLEMENTARY DATA (Unaudited)

Quarterly Financial Data (Unaudited)

| Millions of Dollars Except Per Share Amounts | 1985 by Quarter | | | | 1984 by Quarter | | | |
|--|-----------------|---------|---------|---------|-----------------|---------|---------|---------|
| | First | Second | Third | Fourth | First | Second | Third | Fourth |
| Net Sales | \$175.9 | \$188.1 | \$193.8 | \$174.2 | \$169.9 | \$191.3 | \$203.8 | \$166.3 |
| Cost of Products Sold | 127.1 | 130.2 | 135.1 | 121.4 | 129.8 | 143.8 | 151.1 | 124.3 |
| Gross Profit | \$ 48.8 | \$ 57.9 | \$ 58.7 | \$ 52.8 | \$ 40.1 | \$ 47.5 | \$ 52.7 | \$ 42.0 |
| Income Before Income Taxes and Extraordinary Credits | \$ 19.5 | \$ 25.2 | \$ 24.9 | \$ 17.9 | \$ 10.1 | \$ 15.5 | \$ 17.0 | \$ 12.0 |
| Income Taxes | 8.4 | 9.8 | 9.3 | 5.7 | 2.7 | 3.6 | 4.9 | 2.4 |
| Income Before Extraordinary Credits | 11.1 | 15.4 | 15.6 | 12.2 | 7.4 | 11.9 | 12.1 | 9.6 |
| Extraordinary Credits | 6.4 | 8.4 | 7.3 | 1.2 | 6.2 | 3.2 | 1.5 | 4.8 |
| Net Income | \$ 17.5 | \$ 23.8 | \$ 22.9 | \$ 13.4 | \$ 13.6 | \$ 15.1 | \$ 13.6 | \$ 14.4 |
| Earnings Per Common Share* | | | | | | | | |
| Primary: | | | | | | | | |
| Before Extraordinary Credits | \$.72 | \$.87 | \$.87 | \$.67 | \$.46 | \$.77 | \$.79 | \$.61 |
| Extraordinary Credits | .42 | .48 | .41 | .07 | .42 | .22 | .10 | .33 |
| Net Income | \$ 1.14 | \$ 1.35 | \$ 1.28 | \$.74 | \$.88 | \$.99 | \$.89 | \$.94 |
| Fully Diluted: | | | | | | | | |
| Before Extraordinary Credits | \$.62 | \$.86 | \$.87 | \$.67 | \$.42 | \$.67 | \$.68 | \$.54 |
| Extraordinary Credits | .36 | .47 | .41 | .07 | .34 | .18 | .08 | .27 |
| Net Income | \$.98 | \$ 1.33 | \$ 1.28 | \$.74 | \$.76 | \$.85 | \$.76 | \$.81 |

*In accordance with the provisions of APB Opinion No. 15, earnings per share are calculated separately for each quarter and the full year. Accordingly, annual earnings per share will not necessarily equal the total of the interim periods.

THE PEOPLE OF GAF

Foremost among the causal factors in what we have achieved at GAF over the past two years has been and continues to be my fellow GAF employees. As Chief Executive, I consider myself fortunate to be associated with so many hard working, dedicated and loyal employees who approach their responsibilities and share the objectives of GAF's senior management with an extraordinary degree of intensity." —Chairman's letter to shareholders, March 17, 1986

The people of GAF—4,000 men and women who represent the Company throughout the world—perform many diverse roles, such as secretaries, scientists, production workers, technical salespersons, cafeteria workers, engineers, security guards, computer programmers, and maintenance workers. While only a few GAF employees are depicted here, they are representative of the overwhelming number of GAF people who bring to the discharge of their responsibilities not only abundant energy but an overriding concern for the Company's welfare—as demonstrated by their actions and accomplishments.





Left to right: Raymond W. Smith, Richard H. Jones, William A. Schreiber, Richard H. Jones, William A. Schreiber, Richard H. Jones, William A. Schreiber, Richard H. Jones, William A. Schreiber.

Members

The following members of the Board of Directors are listed in alphabetical order by last name.

Raymond W. Smith
President, Marketing
Richard H. Jones
President, Marketing

William A. Schreiber
President, Marketing
Richard H. Jones
President, Marketing
William A. Schreiber
President, Marketing

William A. Schreiber
President, Marketing
Richard H. Jones
President, Marketing
William A. Schreiber
President, Marketing

William A. Schreiber
President, Marketing
Richard H. Jones
President, Marketing

THE WORLD OF GAF

Corporate Offices

1361 Alps Road
Wayne, New Jersey 07470

Domestic

GAF Corporation's plants, research laboratories and sales offices are located throughout the United States.

Chemicals

Manufacturing

Alabama-Huntsville
Kentucky-Calvert City
Missouri-Annapolis
New Jersey-Bound Brook
New Jersey-Linden
Pennsylvania-Blue Ridge Summit
Texas-Seadrift
Texas-Texas City
Wisconsin-Pembine

Sales Offices

California-Irvine
Illinois-Lombard
New Jersey-Linden
North Carolina-Charlotte
Ohio-Cincinnati
Pennsylvania-King of Prussia
Texas-Arlington

Research & Development

Maryland-Hagerstown
New Jersey-Wayne

Building Materials

Manufacturing

Alabama-Mobile
California-Fontana

California-Irwindale

Florida-Tampa

Georgia-Savannah

Indiana-Mount Vernon

Maryland-Baltimore

Massachusetts-Millis

Minnesota-Minneapolis

Pennsylvania-Erie

South Carolina-Chester

Tennessee-Nashville

Texas-Dallas

Sales Offices

Alabama-Mobile
California-Fontana
Florida-Tampa
Georgia-Savannah
Illinois-Hodgkins
Indiana-Mount Vernon
Maryland-Baltimore
Massachusetts-Millis
Minnesota-Minneapolis
New Jersey-South Bound Brook
Pennsylvania-Erie
Texas-Dallas

Research & Development

New Jersey-Wayne
Tennessee-Nashville

International

GAF Corporation's major marketing and service facilities are located throughout the world.

European Region

Great Britain, Esher-Headquarters
Austria-Vienna
Belgium-Sint Niklaas

France-Paris

Great Britain-Manchester

Italy-Milan

Netherlands-Schiedam

South Africa-Sandton

Spain-Barcelona

Sweden-Johanneshov (headquarters for Norden countries)

Switzerland-Zug

West Germany-Frechen

Western Hemisphere Region

New Jersey, Wayne-Headquarters

Brazil-São Paulo

Canada-Mississauga, Ontario

Canada-Ville St. Laurent, Quebec

Mexico-Mexico City

Puerto Rico-Carolina

Australasia Region

Australia, Sydney-Headquarters

Australia-Melbourne

New Zealand-Auckland

Republic of Singapore-Singapore

North Pacific Region

Japan, Tokyo-Headquarters

GAF Broadcasting Company, Inc.

New York, New York

Subsidiary:

GAF Insurance, Ltd.
Hamilton, Bermuda

Affiliate:

GAF/Hüls Chemie GmbH
Marl, West Germany

SHAREHOLDER INFORMATION

Annual Meeting

The 1986 Annual Meeting of Shareholders will be held at 10 a.m., Monday, April 28 at the Chase Manhattan Bank auditorium; Ground floor, One Chase Manhattan Plaza, New York, NY 10081

Form 10K

A copy of the Company's Annual Report on Form 10K as filed with the Securities and Exchange Commission may be obtained, free of charge, by writing to:
GAF Corporation
Corporate Affairs Department
1361 Alps Road
Wayne, NJ 07470

Dividend Reinvestment Service

GAF offers holders of its common stock the opportunity to buy additional shares through an automatic dividend reinvestment service, administered by Morgan Guaranty Trust Company of New York. For further details contact: Morgan Guaranty Trust Company of New York

30 West Broadway
New York, NY 10015
(212) 587-6515

GAF's common stock is listed on the New York Stock Exchange (symbol: "GAF").

Transfer Agent

Stock-Transfer Agent and Registrar:
Morgan Guaranty Trust Company of New York
30 West Broadway
New York, NY 10015

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GAF

GAF Corporation
1361 Alps Road
Wayne, NJ 07470

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